98TH CONGRESS
1st Session

SENATE

REPORT No.
98-300

OMNIBUS RECONCILIATION ACT OF 1983

REPORT

OF THE

COMMITTEE ON THE BUDGET

UNITED STATES SENATE

TO ACCOMPANY

S. 2062

A BILL TO PROVIDE FOR RECONCILIATION PURSUANT TO SECTION 3 OF THE FIRST CONCURRENT RESOLUTION ON THE BUDGET FOR FISCAL YEAR 1984 (H. CON. RES. 91, NINETY-EIGHTH CONGRESS)

together with

ADDITIONAL VIEWS

NOVEMBER 4, 1983.—Ordered to be printed

U.S. GOVERNMENT PRINTING OFFICE

25-551 O

WASHINGTON : 1983

S253-3

COMMITTEE ON THE BUDGET

PETE V. DOMENICI, New Mexico, *Chairman*

WILLIAM L. ARMSTRONG, Colorado
NANCY LANDON KASSEBAUM, Kansas
RUDY BOSCHWITZ, Minnesota
ORRIN G. HATCH, Utah
JOHN TOWER, Texas
MARK ANDREWS, North Dakota
STEVEN D. SYMMS, Idaho
CHARLES GRASSLEY, Iowa
ROBERT W. KASTEN, Wisconsin
DAN QUAYLE, Indiana
SLADE GORTON, Washington

LAWTON CHILES, Florida
ERNEST F. HOLLINGS, South Carolina
JOSEPH R. BIDEN, JR., Delaware
J. BENNETT JOHNSTON, Louisiana
JIM SASSER, Tennessee
GARY HART, Colorado
HOWARD M. METZENBAUM, Ohio
DONALD W. RIEGLE, JR., Michigan
DANIEL PATRICK MOYNIHAN, New York
J. JAMES EXON, Nebraska

STEPHEN BELL, *Staff Director*
RICHARD N. BRANDON, *Minority Staff Director*
W. THOMAS FOXWELL, *Director of Publications*

CONTENTS

	Page
Views of the Committee on the Budget	3
Reconciliation procedures	5
Summary of reconciliation recommendations	7
Rule XXVI	12
Rollcall votes in committee	13
Title-by-title analysis of the bill	14
I. Committee on Finance	15
II. Committee on Governmental Affairs	185
III. Committee on Small Business	201
IV. Committee on Veterans' Affairs	223
Views of Budget Committee members	231
Additional views of Senator Hollings	231
Additional views of Senator Sasser	234
Additional views of Senator Riegle	236
Additional views of Senator Exon	239

Calendar No. 537

98TH CONGRESS, 1st Session | SENATE | REPORT No. 98-300

OMNIBUS RECONCILIATION ACT OF 1983

NOVEMBER 14, 1983.—Ordered to be printed

Filed under authority of the order of the Senate of NOVEMBER 4 (legislative day, OCTOBER 31), 1983

Mr. DOMENICI, from the Committee on the Budget, submitted the following

REPORT

[To accompany S. 2062]

The Committee on the Budget, which had under consideration an original bill (S. 2062), having considered the same, reports thereon without amendment and without recommendation.

25-551 O

VIEWS OF THE COMMITTEE ON THE BUDGET

Reconciliation is an important tool to restrain Federal spending. It is authorized by Title III of the Congressional Budget and Impoundment Control Act of 1974 (Public Law 93-344). Reconciliation permits the Congress to consider spending reductions and revenue increases from several committees in one bill, while reserving to the individual committees the power to make recommendations for changes in laws within their respective jurisdictions.

Adoption of Reconciliation Instructions

On June 23, 1983, Congress adopted House Concurrent Resolution 91, the First Concurrent Resolution on the Budget for Fiscal Year 1984. That resolution mandated dramatic reductions in the large budget deficits which would otherwise face the Nation. Revenue and spending targets for the fiscal years 1983 through 1986 contained in the resolution will lower deficits over the next 3 years by $110 billion.

In order to help achieve the fiscal policy set forth in House Concurrent Resolution 91, Congress included in that resolution instructions to seven House committees and four Senate committees to recommend changes in laws in their jurisdiction which would cut spending by $8.9 billion in budget authority and $12.3 billion in outlays in the fiscal years 1984 through 1986. In addition, the Senate Finance and the House Ways and Means Committees were given reconciliation instructions to report revenue increases totaling $73 billion during the fiscal year 1984-86 period.

The Senate committees were assigned a reporting date of July 22, 1983. This deadline was extended by the full Senate to September 23, on July 19, to October 17 on September 22, and to October 31 on October 6, respectively. Pursuant to subsection 310(c)(2) of the Budget Act, those committees submitted their reports to the Senate Budget Committee on or before the final deadline. The Budget Committee is responsible for combining the legislative recommendations of these committees into a single bill and for reporting these recommendations to the Senate without any substantive revision.

Reconciliation is a Necessary Tool to Achieve Savings

The Budget Committee believes that the reconciliation process is a necessary procedure by which to achieve many of the reductions in Federal spending and increases in Federal revenues called for by House Concurrent Resolution 91. These changes in the law are necessary in order to wage an effective battle against large Federal deficits and the high interest rates which have plagued the national economy for many months.

This Bill and Report

The Senate Budget Committee reports herewith the recommendations of four Senate committees, without any substantive revision, without recommendation.

Nonbudgetary Provisions

The Budget Committee believes that the inclusion of nonbudgetary provisions in a reconciliation bill is inconsistent with the spirit and letter of the Budget Act, damages the credibility of the budget process, and could have the effect of circumventing Rule XXII of the Standing Rules of the Senate.

The problem of so-called "extraneous matters" became a major issue 2 years ago during Senate consideration of S. 1377, the Omnibus Reconciliation Act of 1981. A number of provisions which were determined to be clearly extraneous were stricken from that bill. A special time agreement was entered into with respect to other provisions which some Senators contended were extraneous.

The Budget Committee has authorized the chairman and ranking member to consult with the chairman and ranking members of committees which have submitted legislation, and with the Senate leadership, to identify any clearly extraneous matters in this bill and to reach an agreement on any amendments which may be necessary to eliminate such matters from the bill. The Budget Committee recommends that any such amendments as may be agreed upon be adopted by the Senate.

Level of Deficit Reduction

Savings.—The total reduction in deficits as reported by the four Senate committees achieve $14.6 billion in outlay savings in fiscal year 1984-86. According to Congressional Budget Office estimates, all four committees whose recommendations are included in this bill met or exceeded the savings levels specified in the reconciliation instructions. Indeed, two committees—Finance and Governmental Affairs—reported legislative savings exceeding their instructions by substantial amounts.

The Committee on Government Affairs submitted its recommendations on September 23, 1983. The committee subsequently revised its recommendations and submitted the revision on October 31, 1983. The letter from the chairman and ranking member of the committee transmitting the revision appears in this report immediately before the original letter of transmittal. The bill as reported reflects this revision.

Revenues. For many reasons, the Finance Committee was unable to make recommendations increasing revenues by the full amount instructed in the budget resolution—$73 billion over fiscal years 1984-86. Efforts were made by that committee to respond to the instructions. These efforts resulted in some delay in bringing this reconciliation bill to the floor. The Finance Committee recommends changes in laws within its jurisdiction so as to increase revenues by $13.4 billion over fiscal years 1984-86.

RECONCILIATION PROCEDURE

Just as the Budget Act provides for the reconciliation procedure, it provides in sections 310(e) and 305 special rules for the consideration of reconciliation bills.

The following rules apply to the consideration of a reconciliation bill in the Senate:

First, debate on any reconciliation bill and all amendments thereto and debatable motions and appeals in connection therewith is limited to 20 hours.

Second, debate on the bill (including amendments, debatable motions, and appeals) shall be equally divided between, and controlled by, the majority leader and the minority leader or their designees.

Third, debate on any amendment is limited to 2 hours, divided between the mover of the amendment and the manager of the bill.

Fourth, debate on any amendment to an amendment, debatable motion, or appeal is limited to 1 hour, divided between the mover and the manager.

Fifth, a motion to limit debate to less than 20 hours is not debatable.

Sixth, a motion to recommit is not in order unless it contains instructions to report back within a specified time, not to exceed 3 days, and debate on such a motion is limited to 1 hour, divided between the mover and the manager.

Seventh, any germane amendment which amends the bill in more than one place and which achieves or maintains mathematical consistency is always in order.

Eighth, amendments to the bill must be "germane to the provisions of" the legislation. The "germaneness rule" has been interpreted as prohibiting any amendment which introduces "new subject matter."

The instructed committees, therefore, set the parameters of germaneness, as the Budget Committee reports what is submitted to it without any substantive revision.

The "germaneness rule" does not apply to a motion to recommit the bill with instructions to report a specific amendment, if a committee has not complied with its reconciliation instructions, and if the effect of the motion would be to bring the bill into compliance with the reconciliation instructions.

Ninth, floor consideration of the conference report on a reconciliation bill is in order any time after the third day following the day on which the conference report is reported and is available to Senators. Debate on the conference report is limited to 10 hours, divided equally, with debate on any appeal or motion limited to 1 hour divided between the mover and the manager.

SUMMARY OF RECONCILIATION RECOMMENDATIONS

The following tables summarize the deficit reductions achieved by the four committees as reported in the bill and compare them to the reconciliation instructions to the four committees. Table 1 provides an overall summary of the bill and the reconciliation instructions. Table 2 provides a summary of spending reductions and revenue increases by committee. Table 3 provides details of the recommendations of each committee.

Revenue and spending estimates for the four committees are stated in terms of changes from the baseline estimates used in developing the First Budget Resolution for FY 1984. The reconciliation instructions for the four committees were constructed using that same baseline.

All of the dollar amounts in the tables have been estimated by the Congressional Budget Office based on the submissions of the four committees to the Budget Committee. Details may not add to totals due to rounding.

Table 1

SUMMARY OF RECOMMENDATIONS

[In millions of dollars]

	FY 1984	FY 1985	FY 1986	Total FY 1984–86
Recommendations in bill:				
Reduction in budget authority	−2,544	−5,405	−5,331	−13,280
Reduction in outlays	−2,847	−5,749	−6,001	−14,597
Increase in revenues	+1,739	+4,555	+7.139	+13,433
Reduction in deficit	−4,586	−10,304	−13,140	−28,030
Reconciliation instructions to committees:				
Reduction in budget authority	−1,986	−3,026	−3,920	−8,932
Reduction in outlays	−2,813	−3,945	−5,527	−12,285
Increase in revenues	+12,000	+15,000	+46,000	+73,000
Reduction in deficit	−14,813	−18,945	−51,527	−85,285

Table 2

SUMMARY OF RECOMMENDATIONS BY COMMITTEE

[In millions of dollars]

Committee	FY 1984	FY 1985	FY 1986	Total FY 1984–86
Finance:				
Budget authority	−662	−1,150	−1,611	−3,423
Outlays	−561	−1,145	−1,631	−3,337
Revenues	+1,769	+4,525	+7,139	+13,433
Governmental Affairs:				
Budget authority	−1,515	−3,561	−3,035	−8,111
Outlays	−1,773	−4,000	−3,787	−9,560
Revenues	−30	+30		
Small Business:				
Budget authority	−139	−555	−544	−1,238
Outlays	−287	−466	−443	−1,196
Veterans' Affairs:				
Budget authority	−228	−139	−141	−508
Outlays	−226	−138	−140	−504
Total recommendations in bill:				
Budget authority	−2,544	−5,405	−5,331	−13,280
Outlays	−2,847	5,749	−6,001	−14,597
Revenues	+1,739	+4,555	+7,139	+13,433
Deficit	−4,586	−10,304	−13,140	−28,030
Total reconciliation instructions to committees:				
Budget authority	−1,986	−3,026	−3,920	−8,932
Outlays	−2,813	−3,945	−5,527	−12,285
Revenues	+12,000	+15,000	+46,000	+73,000
Deficit	−14,813	−18,945	−51,527	−85,285

Table 3

DETAILS OF RECOMMENDATIONS BY COMMITTEE

[In millions of dollars]

		FY 1984	FY 1985	FY 1986	Total FY 1984-86
TITLE I					
FINANCE COMMITTEE					
Spending reduction:					
Medicare part B premiums	BA	.....	.....	−359	−359
	O	.....	.....	−359	−359
Medicare physicians' services	BA	−400	−659	−764	−1,823
	O	−320	−630	−740	−1,690
Medicare clinical laboratory services	BA	−100	−148	−51	−299
	O	−75	−175	−70	−320
Medicare part B deductible	BA	−66	−132	−183	−381
	O	−50	−115	−180	−345
Medicaid third party liability collections	BA	−30	−100	−112	−242
	O	−30	−100	−112	−242
Other medicare and medicaid changes, net	BA	−2	−1	−5	−8
	O	+2	−1	−26	−25
Aid to families with dependent children	BA	−133	−179	−184	−496
	O	−133	−179	−184	−496
Supplemental security income program	BA	−10	−16	−17	−43
	O	−10	−16	−17	−43
Maternal and child health and other program authorizations	BA	+79	+85	+64	+228
	O	+55	+71	+57	+183
Total spending reduction in Title I [1]	BA	−662	−1,150	−1,611	−3,423
	O	−561	−1,145	−1,631	−3,337
Reconciliation instruction to committee	BA				
	O	−400	−500	−800	−1,700
Revenue increase:					
Alternative minimum tax		+557	+54	+45	+656
Collapsible corporations		+7	+75	+239	+321
Capital gains		.....	+424	+307	+731
Straddles		+178	+394	+94	+666

Table 3—Continued

[In millions of dollars]

		FY 1984	FY 1985	FY 1986	Total FY 1984–86
Sport fishing excise taxes		.....	+12	+13	+25
Public property leasing		+511	+1,011	+1,848	+3,370
Net interest exclusion		.....	+1,024	+2,858	+3,882
Income averaging		+306	+1,255	+1,372	+2,933
Compliance		+33	+92	+170	+295
Corporate graduated rates		+104	+177	+185	+466
Withholding on foreign investment.		+73	+7	+8	+88
Total revenue increase in Title I.		+1,769	+4,525	+7,139	+13,433
Reconciliation instruction to committee.		+12,000	+15,000	+46,000	+73,000
TITLE II					
GOVERNMENTAL AFFAIRS COMMITTEE					
Spending reduction:					
Cost-of-living adjustments	BA	−258	−1,804	−556	−2,628
	O	−534	−2,168	−1,224	−3,946
Federal employee pay raises	BA	−1,250	−1,843	−2,475	−5,568
	O	−1,260	−1,888	−2,541	−5,689
Re-employed military retirees.	BA	+26	+60	.....	+86
	O	+24	+60	+2	+86
Military service credits for civil service retirement	BA	−30	+30		
	O	.....			
Panama Canal Zone employee pay.	BA	−3	−4	−4	−11
	O	−3	−4	−4	−11
Total spending reduction in Title II.	BA	−1,515	−3,561	−3,035	−8,111
	O	−1,773	−4,000	−3,787	−9,560
Reconciliation instruction to committee.	BA	−1,619	−2,332	−3,235	−7,186
	O	−1,900	−2,841	−4,144	−8,885

Table 3—Continued

[In millions of dollars]

		FY 1984	FY 1985	FY 1986	Total FY 1984-86
Revenue change:					
Military service credits for civil service retirement (total revenue change in Title II)		−30	+30	.....	.....
Reconciliation instruction to committee.		....	.....	.....	.....
TITLE III					
SMALL BUSINESS COMMITTEE					
Disaster loans (total spending reduction in Title III).	BA	−139	−555	−544	−1,238
	O	−287	−466	−443	−1,196
Reconciliation instruction to committee.	BA	−139	−555	−544	−1,238
	O	−287	−466	−443	−1,196
TITLE IV					
VETERANS' AFFAIRS COMMITTEE					
Veterans compensation (total spending reduction in Title IV).	BA	−228	−139	−141	−508
	O	−226	−138	−140	−504
Reconciliation instruction to committee.	BA	−228	−139	−141	−508
	O	−226	−138	−140	−504

[1] Does not include spending increases of $825 million in budget authority and $730 million in outlays over FY 1984-86 which CBO estimates will occur in various programs as a result of the above provisions.

RULE XXVI

In compliance with Rule XXVI, paragraphs 11(b) (regulatory impact) and 12 (comparative prints of proposed legislation) of the Standing Rules of the Senate, it is the opinion of the Budget Committee that it is necessary to dispense with these requirements of the rule in order to expedite the business of the Senate.

However, with respect to any committee which has submitted reconciliation recommendations and has transmitted to the Budget Committee changes in existing law, those changes are incorporated in this report without revision, in the title-by-title analysis.

ROLLCALL VOTES IN COMMITTEE

Votes taken during Committee consideration of this legislation were as follows:

Gorton motion to report to the Senate the Omnibus Reconciliation Act of 1983 without recommendation.

Motion agreed to by 13 yeas, 4 nays as follows:

YEAS	NAYS
Mrs. Kassebaum	Mr. Hatch
Mr. Boschwitz	Mr. Grassley
Mr. Andrews (by proxy)	Mr. Kasten
Mr. Quayle	Mr. Hollings (by proxy)
Mr. Gorton	
Mr. Chiles	
Mr. Biden	
Mr. Johnston	
Mr. Sasser	
Mr. Metzenbaum	
Mr. Riegle	
Mr. Exon	
Mr. Domenici	

25-551 O—83——2

TITLE-BY-TITLE ANALYSIS

The following is a title-by-title analysis of the legislation. In each case, the analyses of the respective committees are presented without revision, except that attachments and enclosures referred to in committee submissions that are a part of their legislative language have been extracted and inserted in the Omnibus Reconciliation Act of 1983.

In addition, the final cost estimates by the Congressional Budget Office were not in some instances available to the committees when they made their submissions to the Budget Committee. In those cases the CBO cost estimates have been added to the materials submitted by the committees.

COMMITTEE ON FINANCE

Title I

ROBERT J. DOLE, KANS., CHAIRMAN

BOB PACKWOOD, OREG.
WILLIAM V. ROTH, JR., DEL.
JOHN C. DANFORTH, MO.
JOHN H. CHAFEE, R.I.
JOHN HEINZ, PA.
MALCOLM WALLOP, WYO.
DAVID DURENBERGER, MINN.
WILLIAM L. ARMSTRONG, COLO.
STEVEN D. SYMMS, IDAHO
CHARLES E. GRASSLEY, IOWA

RUSSELL B. LONG, LA.
LLOYD BENTSEN, TEX.
SPARK M. MATSUNAGA, HAWAII
DANIEL PATRICK MOYNIHAN, N.Y.
MAX BAUCUS, MONT.
DAVID L. BOREN, OKLA.
BILL BRADLEY, N.J.
GEORGE J. MITCHELL, MAINE
DAVID PRYOR, ARK.

ROBERT E. LIGHTHIZER, CHIEF COUNSEL
MICHAEL STERN, MINORITY STAFF DIRECTOR

United States Senate
COMMITTEE ON FINANCE
WASHINGTON, D.C. 20510

October 31, 1983

The Honorable Pete V. Domenici
Chairman
Committee on the Budget
United States Senate
203-Carroll Arms
Washington, D.C. 20510

Dear Pete:

Enclosed please find statutory language implementing the recommendations of the Senate Committee on Finance to meet its reconciliation instruction.

The provisions would reduce spending levels in the programs within the jurisdiction of this Committee by $3 billion over FY 84-86. The revenue provisions would increase Federal receipts by $13.4 billion over the same period.

Sincerely,

BOB DOLE
CHAIRMAN

BD: gp

BEST COPY AVAILABLE

CONTENTS

	Page
I. Summary:	
A. Revenue Provisions	21
B. Spending Reduction Provisions	27
II. General Reasons:	
A. Revenue Provisions	33
B. Spending Reduction Provisions	34
III. Budget Effects:	
A. Revenue Effects of Tax Provisions	36
B. Spending Reduction Provisions	37
IV. Explanation of Revenue Reconciliation Provisions:	
A. Individual Income Tax Provisions	40
1. Estimated tax payments of alternative minimum tax	40
2. Modification of income averaging	41
3. Postponement of net interest exclusion	42
4. Exclusion from gross income for cancellation of certain student loans	43
B. Corporate Tax Rate Change	46
C. Tax-Exempt Entity Leasing	47
1. Overview	58
2. Definition of tax-exempt entity	58
3. Tax-exempt use property	59
4. Depreciation	64
5. Investment tax credit	66
6. Property used under certain service contracts	67
7. Short-term lease exception	79
8. Lease term	79
9. Definition of related party	80
10. Exceptions	80
D. Tax Treatment of Capital Gains and Losses	83
1. Decrease in holding period required for long-term capital gain treatment	83
2. Deduction of capital losses against ordinary income	84
3. Revenue effect of capital gains and loss provisions	84
E. Excise Tax on Sport Fishing Equipment and Financing of Sport Fish Restoration and Federal Boating Safety Programs; Excise Tax on Certain Arrows	85
1. Revenue provisions	85
2. Trust Fund provisions	93
3. Amendments to the Federal Aid to Sport Fish Restoration Act	100

BEST COPY AVAILABLE

Page

4. Amendments to the Federal Boat Safety Act..... 102
5. Expansion of excise tax on certain arrows 104
F. Prevention of Tax Avoidance 105
1. Treatment of stock option straddles and other options 105
2. Foreign investment companies..... 109
3. Collapsible corporations..... 116
G. Taxpayer Compliance Provisions 119
1. Promoter lists of syndicate participants..... 119
2. Reporting of cash transactions and mortgage interest 120
3. Tax Court small tax case provisions 122
4. Interest rate on tax-shelter syndicate items..... 123
5. Reporting on discharge of indebtedness 124
6. Penalty for promoting abusive tax shelters..... 126
7. Changes in accounting methods..... 127
8. Regulation of appraisers..... 127
9. Revenue effect of compliance provisions..... 128
H. Withholding on Dispositions of Foreigners of United States Real Property Interests..... 129

V. Explanation of Spending Reduction Provisions:

A. Medicare and Medicaid and Other Health Provisions 133
1. Extension of Limitation on Part B Premium Increases (sec. 151 of the bill)..... 133
2. Limitation on Physician Fee Prevailing Charge Levels (sec. 152 of the bill)..... 134
3. Hepatitis B. Vaccine (sec. 153 of the bill)..... 135
4. Limitation on Certain Foot Care Services (sec. 154 of the bill) 135
5. Coverage of Hemophilia Clotting Factor (sec. 155 of the bill) 136
6. Fee Schedule for Clinical Laboratory Services (sec. 156 of the bill)..... 137
7. Index Part B Deductible (sec. 157 of the bill)..... 138
8. Reduce Reimbursement to Home Health Agencies for Durable Medical Equipment (sec. 158 of the bill)..... 138
9. Increase Medicaid Ceilings for Puerto Rico and the Territories (sec. 159 of the bill)..... 139
10. Increase Authorization for Maternal and Child Health Block Grant Program (sec. 160 of the bill) 140
11. Medicaid Coverage for Pregnant Women (sec. 161 of the bill) 140
12. Delay of Effective Date for Single-Rate for Skilled Nursing Facilities (sec. 162 of the bill). 141
13. Recertification of SNF/ICF Patients (sec. 163 of the bill)..... 141
14. Study on Payments for Physicians Cognitive Skills (sec. 164 of the bill) 143
15. Elimination of Part B Deductible for Certain Diagnostic Laboratory Tests (sec. 165 of the bill) 144

Page

16. Payment for Services Following Termination of Participation Agreements With Home Health Agencies and Hospices (sec. 166 of the bill) 144
17. Repeal of Special Tuberculosis Treatment Requirements Under Medicare and Mediciad (sec. 167 of the bill) 145
18. Medicare Recovery Against Certain Third Parties (sec. 168 of the bill) 145
19. Indirect Payment of Supplementary Medical Insurance Benefits (sec. 169 of the bill) 146
20. Elimination of Health Insurance Benefits Advisory Council (sec. 170 of the bill) 146
21. Hospital Accreditation Surveys of the American Osteopathic Association Not To Be Disclosed (sec. 171 of the bill) 147
22. Flexible Sanctions for Noncompliance With Requirements for End Stage Renal Disease Facilities (sec. 172 of the bill) 147
23. Use of Additional Accrediting Organizations Under Medicare (sec. 173 of the bill) 148
24. Repeal of Exclusion of For-Profit Organizations From Research and Demonstration Grants (sec. 174 of the bill) 148
25. Requirements for Medical Review and Independent Professional Review Under Medicaid (sec. 175 of the bill) 148
26. Flexibility in Setting Payment Rates for Hospitals Furnishing Long-Term Care Services Under Medicaid (sec. 176 of the bill) 149
27. Authority of Secretary To Issue and Enforce Subpoenas Under Medicaid (sec. 177 of the bill) 149
28. Repeal of Authority for Payments To Promote Closing and Conversion of Underutilized Hospitals (sec. 178 of the bill) 150
29. Presidential Appointment of and Pay Level for the Administrator of the Health Care Financing Administration (sec. 179 of the bill) 150
30. Exclusion of Certain Entities Owned or Controlled by Individuals Convicted of Medicare or Medicaid Related Crimes (sec. 180 of the bill) 150
31. Judicial Review of Provider Reimbursement Review Board Decisions (sec. 181 of the bill) 151
32. Access to Home Health Services (sec. 182 of the bill) 151
33. Publication of Physician Assignment List (sec. 183 of the bill) 152
34. Permitting Limited Provider Representation on Peer Review Organizations (sec. 184 of the bill) 153
35. Prospective Payment Assessment Commission (sec. 185 of the bill) 154

Page

36. Medicaid Clinic Administration (sec. 186 of the bill) 155
37. Eliminate Part B Penalty for Working Aged (sec. 187 of the bill) 155
38. Hospital Emergency Room Services (sec. 188 of the bill) 156
39. Nurse Anesthetists (sec. 189 of the bill) 156
40. Prospective Payment Wage Index (sec. 190 of the bill) 158
41. Hospice Contracting (sec. 191 of the bill) 158
42. Payment for Psychiatric Hospitals (sec. 192 of the bill) 159
43. Accreditation of Psychiatric Hospitals (sec. 193 of the bill) 160
44. Teaching Physician Payments Under Medicare (sec. 194 of the bill) 160
45. Cardiac Pacemakers (sec. 195 of the bill) 161
46. Health Maintenance Organizations and Competitive Medical Plans (sec. 196 of the bill) 162

Other Considerations 164

B. Income Maintenance Provisions 165

Aid to Families With Dependent Children (AFDC) Provisions 165

1. Parents and Siblings of Dependent Child Included in Filing Unit (sec. 197 of the bill) 165
2. Households Headed by Minor Parents (sec. 198 of the bill) 166
3. Clarification of Earned Income Provisions (sec. 199 of the bill) 167
4. CWEP Work for Federal Agencies (sec. 199A of the bill) 168
5. Treatment of Student Earnings (sec. 199B of the bill) 168

Supplemental Security Income (SSI) Provisions 169

1. Adjustment in SSI Benefits on Account of Retroactive Benefits Under Title II (sec. 199C of the bill) 169
2. Third Party Liability Collections (sec. 199D of the bill) 170

VI. Costs of Carrying Out the Revenue Reconciliation Provisions and Vote of the Committee 171

VII. Regulatory Impact and Other Matters To Be Discussed Under Senate Rules 172

VIII. Changes in Existing Law 184

I. SUMMARY PROVISIONS OF THE SENATE FINANCE COMMITTEE'S RECONCILIATION RECOMMENDATIONS

A. Revenue Provisions

Estimated Tax Payments of Alternative Minimum Tax

Under present law, individuals generally are required to make estimated tax payments (including withholding payments) equal to 80 percent of the current year's income tax. Estimated tax payments of the alternative minimum tax are not required.

The bill requires individuals to make estimated tax payments of the alternative minimum tax, effective for taxable years beginning after December 31, 1983.

Modification of Income Growth Threshold for Income Averaging

Under present law, if an eligible individual has averageable income, i.e., an excess of current year taxable income over 120 percent of average taxable income in the previous 4 years, then the individual may be eligible for income averaging. Under income averaging, the tax liability attributable to averageable income is computed by using only the marginal rates applicable to the first 20 percent of averageable income.

The bill modifies the definition of averageable income to be the amount by which current year taxable income exceeds 140 percent, instead of 120 percent, of average taxable income in the previous 4 years.

Postponement of Net Interest Exclusion

The Economic Recovery Tax Act of 1981 provides for an exclusion of 15 percent of net interest received up to $3,000 of net interest ($6,000 on a joint return) beginning in 1985. Under the bill, the net interest exclusion will not become effective until 1987.

Exclusion From Gross Income for Cancellation of Certain Student Loans

The bill extends the exclusion for amounts realized by reason of cancellation of student loans in return for certain professional services for a two-year period, through December 31, 1984. Additionally, the bill broadens the exclusion to include loans made by tax-exempt public hospital corporations.

Phaseout of Graduated Rates for Large Corporations

Under present law, the first $100,000 of corporate taxable income is taxed at graduated rates. The taxable income in excess of $100,000 is taxed at the 46-percent rate. The graduated tax rates

provide a tax reduction of $20,250 to corporations with taxable income in excess of $100,000 relative to a flat 46-percent tax.

The bill provides that the benefits of the graduated rates will effectively be phased out for any corporation with taxable income in excess of $1 million. An additional 5-percent tax, not to exceed $20,000 in amount, is imposed on a corporation's taxable income in excess of $1 million. This provision is effective for taxable years beginning after December 31, 1983.

Tax-Exempt Entity Leasing

Present law

The Federal income tax benefits of ownership of property generally include accelerated depreciation deductions and investment tax credits. Essentially, the law is that the economic substance of a transaction, not its form, determines who is entitled to the tax benefits associated with ownership. Thus, in a lease or similar arrangement, the person claiming ownership for Federal income tax purposes must show that he has sufficient economic indicia of ownership.

The tax benefits of ownership are generally allowed only for property used for a business or income-producing purpose. They are not available for property that is owned by governmental units and tax-exempt organizations. Property that is used (though not owned) by a tax-exempt organization or a domestic governmental unit, including property used under a lease, qualifies for accelerated cost recovery (ACRS) or other depreciation deductions but generally does not qualify for investment credits. A statutory exception to the investment credit limitation provides that qualified rehabilitation expenditures for a building leased to a tax-exempt organization or a governmental unit can qualify for the rehabilitation tax credit. Also, one court has held, and the Internal Revenue Service (IRS) has ruled, that investment credits can be claimed where a governmental unit essentially contracts not for the use of property itself, but rather for a service to be provided by the owner of the property.

Property used by a foreign government or person is not subject to the nontaxable use restriction. However, if the property is used predominantly outside the United States, generally ACRS deductions are slowed down and no investment credit is allowed.

Only 50 percent of the investment credit otherwise allowable is allowable with respect to property owned by a thrift institution, but no such limitation specifically applies with respect to property leased to it. Furthermore, certain property owned by or leased to a public utility is subject to special depreciation and investment credit rules. However, those rules are not specifically applicable to property used to provide services to the public utility.

The bill

In general, the bill reduces the tax benefits available for certain property that is leased to or otherwise used by tax-exempt entities. Under the bill, tax-exempt entities include the United States, any State or local governmental unit, possessions of the United States, and most agencies and instrumentalities of any of the foregoing.

The term also includes (1) organizations (other than farmers' cooperatives described in section 521) exempt from United States income tax and certain formerly exempt organizations and (2) certain foreign persons or entities.

The bill generally requires that ACRS or other depreciation deductions for property used by tax-exempt entities be computed using the straight-line method over a recovery period equal to the greater of the present class life of the property under the Asset Depreciation Range (ADR) system (40 years in the case of 15-year real property) or, in the case of property subject to a lease, 125 percent of the term of the lease. In the case of 15-year real property, this provision applies to the extent of use of a type or types specified in the bill, but only if more than 50 percent (35 percent in the case of use of a type or types specified in the bill by one tax-exempt entity and related tax-exempt entities) of the property is so used. The depreciation rules of the bill do not apply to certain short-lived property leased for a limited term. Depreciation deductions for property used by foreign persons or entities will be computed using the 175-percent declining balance method for property placed in service in 1984 and the 150-percent declining balance method for property placed in service after 1984.

The bill also provides criteria for determining whether a transaction that is structured as a service contract or other arrangement should be treated as a lease for all Federal income tax purposes. The rehabilitation credit is denied for tax-exempt use real property. Finally, lessors are denied investment credits with respect to property leased to thrift institutions in excess of the credits that would have been allowed to the lessee had the lessee owned the property. Property used by foreign persons or entities and currently eligible for the investment credit is restricted to one-half of the credit if placed in service in 1984. If placed in service after 1984, such property generally is ineligible for the credit.

The bill does not apply to property leased to a tax-exempt entity for a short term. For depreciation purposes, a short-term lease is a lease with a term not in excess of 1 year or 30 percent of the property ADR mid-point life (but not more than 3 years), whichever is greater. For investment credit purposes, a short-term lease is a lease of less than 6 months, although for certain foreign property, the depreciation short-term lease rule applies.

The bill generally applies to property placed in service by the taxpayer after May 23, 1983, and to property used under an agreement entered into after that date. However, transitional rules are provided.

Six-Month Long-Term Holding Period and Reduction of Capital Loss Offset Against Ordinary Income

Gains and losses from the sale or exchange of capital assets held for more than 1 year are long-term capital gain or loss and gains and losses from capital assets held for 1 year or less are short-term, under present law. For noncorporate taxpayers, net capital losses may be deducted against $3,000 of ordinary income. However, only 50 percent of long-term losses realized after 1969 may be deducted against ordinary income.

The bill reduces the long-term capital gain and loss holding period to 6 months for assets acquired after November 1, 1983. For taxable years after 1983, the $3,000 ordinary income ceiling against which capital losses may be deducted is reduced to $1,000, and the special treatment of long-term losses realized prior to 1970 is repealed.

Sport Fish Restoration and Boating Safety Funds; Excise Tax on Certain Arrows

The bill replaces the present manufacturers excise tax on fishing equipment with an expanded tax imposed on the last sale of sport fishing equipment before retail. Certain articles are subject to the new tax at a 10-percent rate and others (i.e., tackle boxes, fishfinders, and electric outboard motors) at a 3-percent rate. The bill also extends the time for payment of the tax by manufacturers having $100,000 or less of gross sales receipts in the preceding calendar year, with payments by such taxpayers to be required on a quarterly basis.

Further, the bill alters the financing sources and expenditure purposes for the existing sport fish restoration and boating safety programs and the financing sources for the Land and Water Conservation Fund. Among these changes, the bill transfers part of the revenues from the existing tax on motorboat fuels to the sport fish restoration program. The bill also transfers administration of funding for the sport fish restoration and boating safety programs to a new Aquatic Resources Trust Fund to be included in the Internal Revenue Code.

Also, the bill expands the existing tax on arrows to include arrows used by crossbow hunters.

These provisions generally are effective on October 1, 1984; the tax on tackle boxes and fishfinders will apply on October 1, 1985.

Tax Straddle Provisions

Straddles rules applicable to options

Under present law, stock and exchange-traded stock options are not subject to the tax straddle rules. Options on futures contracts appear to be outside the mark-to-market rules applicable to regulated futures contracts (RFCs) although the taxpayer acquires an RFC when the option is exercised. Some argue that certain cash settlement options do not result in capital gain or loss under present law.

The bill brings stock options, and stock that is offset by an option, within the tax straddle rules. Options on futures are brought within the definition of RFCs. The bill clarifies that gains and losses from cash settlement options are capital gain and losses notwithstanding the cash-settlement feature.

Offshore commodity funds

Under present law, taxpayers contend that a foreign corporation that is widely held by U.S. persons may establish a subsidiary to invest in U.S. commodities markets without any of the parties incurring U.S. tax. They also contend that when the U.S. sharehold-

ers eventually dispose of their shares in the foreign corporation they will be subject to tax at only the capital gains rate.

The bill in certain cases applies the accumulated earnings tax to earnings from U.S. investments, even after those earnings pass through corporate solution as dividends or interest. It also generally treats gains of U.S. shareholders from such investments as ordinary income.

Corporations formed to straddle

Taxpayers may attempt to avoid the tax straddle rules by forming corporations, typically foreign corporations, to take positions to offset their own. The bill treats such stock ownership as a position for the purposes of the straddle rules. This treatment would prevent a taxpayer from recognizing losses when the taxpayer uses a corporation for straddling purposes.

Collapsible Corporations

In general, under present law, a collapsible corporation is one which is formed or availed of with a view (on the part of those in control of the corporation) to realize the value of the corporation's collapsible assets before the corporation has realized a "substantial part" of the taxable income to be derived from such property. Under the bill, the substantial part requirement would be defined to be "two-thirds" of the taxable income to be derived from the property .

The "70/30" rule of present law is amended to authorize Treasury regulations specifying the extent to which all inventory assets must be aggregated and treated as a single asset in determining whether the gain attributable to such assets should be treated as attributable to collapsible assets for purposes of the "70/30" rule.

Compliance Provisions

The committee bill contains eight amendments concerning compliance with the Internal Revenue laws. The first relates to illegal-source income and cash transactions. Persons who receive more than $10,000 in currency in transactions related to their trade or business and persons who receive mortgage interest payments in excess of $2,300 must report on those receipts to the Internal Revenue Service.

Two additional provisions impose new information-gathering or reporting requirements. Specifically, promoters of tax shelter investments are required to maintain customer lists which may be examined by the Internal Revenue Service. The second reporting requirement relates to information on foreclosures, abandonments, and bad debt deductions which may give rise to discharge of indebtedness income to the borrower.

Two of the provisions adopted by the committee bill relate to the increasing backlog of cases in the Tax Court and the backlog of tax shelter cases. These provisions increase the dollar limit on small tax cases in the Tax Court to $10,000 and provide a special, higher interest rate in pre-1983 tax shelter cases for interest accruing after 1983.

The other compliance provisions of the committee bill increase the promoter penalty enacted in 1982, permit the Treasury to bar appraisers from practice before the Treasury, and clarify the circumstances under which taxpayers using improper methods of accounting may be subjected to a penalty.

Withholding On Dispositions by Foreigners of United States Real Property Interests

Under the Foreign Investment in Real Property Tax Act of 1980, foreign persons who dispose of U.S. real property interests generally are required to pay tax on any gain realized on the disposition. The Act provides for enforcement of the tax on foreign persons through a system of information reporting designed to identify foreign owners of U.S. real property interests.

The bill allows replacement of the information reporting system with a withholding system. Generally, the bill requires withholding of a certain portion of the sales price by a transferee of U.S. real estate, any agent of a transferee, or any settlement officer or transferor's agent (hereinafter collectively referred to as the withholding agent) where a U.S. real property interest is acquired from a foreign person. Withholding generally is required only if the withholding agent knows (or has received notice from the transferor or his agent) that the transferor is a foreign person. The bill provides for exemptions from withholding in certain cases including that in which the transferee is to use the real property as his principal residence and the purchase price is $200,000 or less.

B. SUMMARY OF SPENDING REDUCTION PROVISIONS

I. Medicare, Medicaid, 2nd Other Health Provisions

Modification of Part B Premium

Continues for one year the temporary suspension in the limitation on increases in the Part B Premium.

Freeze "Reasonable Charges" for Physician Service

Until July 1, 1984, reimbursement for physicians' services reverts to the prevailing charge limits that were in effect prior to the annual updating that occurred on July 1, 1983.

Hepatitis B Vaccine

Permits medicare coverage of Hepatitis B vaccine for End Stage Renal Disease dialysis patients.

Limitation on Certain Foot Care Services

Requires the Secretary to issue regulations establishing coverage guidelines under the medicare program for debridement of mycotic toenails.

Coverage of Hemophilia Clotting Factor

Permits medicare coverage for the supplies and products necessary for the self-administration of the clotting factor used by individuals who have hemophilia.

Fee Schedule for Clinical Laboratory Services

Directs that a fee schedule be established for all clinical laboratory services provided to medicare beneficiaries except for hospital-based laboratory services.

Index the Part B Deductible

Indexes the amount of the Part B deductible in calendar years 1984, 1985, and 1986, by the percentage by which the medicare economic index increases each year.

Reduce Reimbursement for Durable Medical Equipment Provided by the Home Health Services Agencies

Reimburses home health agencies for durable medical equipment at 80 percent of reasonable costs and permits the agencies to bill beneficiaries for the remaining 20 percent.

Increase Medicaid Ceilings for Puerto Rico and the Territories

Increases funding to Puerto Rico, the Virgin Islands, Guam, the Northern Marianas, and American Somoa.

Increase in the Authorization for the Maternal and Child Health (MCH) Block Grant

Permanently increases the authorization level for the MCH block grant to $455 million in 1986.

Medicaid Coverage for Pregnant Women

Mandates States to provide Medicaid coverage beginning with the medical determination of pregnancy to every woman who would be eligible for Aid to Families with Dependent Children if the child were born.

Delay Implementation of Single Limit for Skilled Nursing Facilities (SNFs)

Further delays without interruption the effective date for the single reimbursement limit for SNFs until March 31, 1984.

Recertification of Skilled Nursing Facility/Intermediate Care Facility Patients

Modifies the frequency with which physician's recertify medicaid patients institutionalized in nursing homes.

Study of Physician Reimbursement

Directs the Office of Technology Assessment to report to the Congress on ways to modify the existing system for determining Medicare alowances to eliminate any inequities that exist between reimbursement levels for medical procedures and cognitive services.

Elimination of Part B Deductible for Certain Diagnostic Laboratory Tests

Eliminates application of the annual Part B deductible in the case of diagnostic tests performed in a laboratory which has entered into a negotiated rate agreement with the Secretary.

Payment for Services Following Termination of Participation Agreement With Home Health Agencies

Changes the ending date of coverage for services provided under a plan of care following termination of a participation agreement with a home health agency or hospice.

Repeal of Special Tuberculosis Treatment Requirements of Medicare and Medicaid

Repeals special tuberculosis treatment requirements under Medicare and Medicaid.

Medicare Recovery Against Certain Third Parties

Establishes the statutory right of medicare to recover directly from a liable third party if the beneficiary himself does not do so.

Indirect Payment of Supplementary Medical Insurance Benefits

Permits Part B payments to be paid to a health benefits plan whose payment is accepted by the physician or other supplier as payment in full.

Elimination of Health Insurance Benefits Advisory Council

Eliminates the Health Insurance Benefits Advisory Council (HIBAC).

Information From Accreditation Surveys of the American Osteopathic Association

Extends the same disclosure protections given the Joint Commission on the Accreditation of Hospitals (JCAH) survey information to similar survey information provided to the Secretary by the American Osteopathic Association.

Flexible Sanctions for Noncompliance With Requirements for End Stage Renal Disease (ESRD) Facilities

Allows the Secretary to apply intermediate sanctions, such as a graduated reduction of reimbursement, to ESRD facilities when noncompliance does not jeopardize patient health or safety or justify decertification of such facilities.

Use of Additional Accrediting Organizations Under Medicare

Extends the Secretary's authority to permit him to rely on accrediting organizations in determining whether rural health clinics, laboratories, clinics, rehabilitation facilities, and public health agencies meet medicare requirements.

Repeal of Exclusion of For-Profit Organizations From Research and Demonstration Grants

Extends the existing research and demonstration grant authority to for-profit organizations as well as nonprofit organizations.

Requirements for Medical Review and Independent Professional Review

Makes consistent State Medicaid plan requirements for medical review in skilled nursing facilities and independent professional review in intermediate care facilities.

Flexibility in Setting Rates for Hospital Furnished Long-Term Care

Eliminates the specific medicaid requirements for setting payment rates applicable only to hospital furnished long-term care services.

25-551 O—83——3

Authorize Secretary to Issue and Enforce Subpoenas

Authorizes the Secretary to issue and seek enforcement of subpoenas under Medicaid to the same extent as under the Medicare program.

Repeal Authority for Payments to Promote Closing and Conversion of Underutilized Hospitals

Repeals the present law authority under which the Secretary may make Medicare and Medicaid payments to cover capital and increased operating costs associated with the conversion or closing of underutilized hospital facilities.

Appointment of Administrator of Health Care Financing Administration (HCFA)

Provides for appointment of the Administrator of HCFA by the President, with the advice and consent of the Senate.

Exclusion of Entities Owned or Controlled by Individuals Convicted of Medicare or Medicaid Related Crimes

Extends the Secretary's current authority to exclude from medicare and medicaid parties convicted of program related crimes.

Judicial Review

Clarifies the effective date of certain provisions of the "Social Security Amendments of 1983" (P.L. 98-21) dealing with judicial review.

Access to Home Health Services

Permits physicians with certain financial interests in certain home health agencies to carry out certification and plan of care functions for patients.

Publication of Physician Assignment List

Requires the Secretary of HHS to make available annually a listing of all physicians who historically have accepted assignment on at least 25 percent of their Medicare billings.

Provider Representation in Peer Review Organizations (PROs)

Provides that a PRO governing body may include a governing body member, officer, or managing employee of a health care facility.

Prospective Payment Assessment Commission

Includes a number of amendments to clarify the manner in which the Commission is to function.

Medicaid Clinic Administration

Makes it clear that the administrator of a clinic need not be a physician.

Eliminate Part B Penalty for Working Aged

Waives the Part B delayed enrollment penalty for workers age 65 through 69 who elect private coverage under the provisions of TEFRA for the period of such coverage.

Hospital Emergency Room Services

Modifies Section 1861(v) of the Social Security Act to include a definition of "bona fide" emergency.

Nurse Anesthetists

Requires that the costs a hospital incurs in employing Certified Registered Nurse Anesthetists (CRNAs) be reimbursed on a reasonable cost basis.

Prospective Payment Wage Index

Directs the Secretary of HHS to remedy problems which exist in the calculation of the wage index for hospital workers.

Hospice Contracting

Allows the Secretary to waive the nursing care "core services" requirements for certain hospices.

Payment for Psychiatric Hospital Services

Delays until July 1, 1985, the application of any reimbursement reductions required to be made to public psychiatric hospitals due to the level of care received by medicaid patients is such hospital.

Participation of Psychiatric Hospitals

Permits psychiatric hospitals and psychiatric units of general hospitals to participate in medicare and medicaid on the basis of a survey by the Secretary of HHS or, if found appropriate, accreditation by the American Osteopathic Association.

Part B Payment of Physicians in Teaching Hospitals

Modifies the calculation of medicare reimbursement to teaching physicians associated with hospitals with large medicaid patient populations.

Cardiac Pacemakers

Directs the Secretary to study the impact technology should have on the costs of physician services, publish guidelines on the frequency and appropriate payment levels for trans-telephonic monitoring, and establish a manufacturer-administered pacemaker registry.

Coordinated Open Enrollment

Allows the Secretary up to three years to coordinate an open enrollment period in each area serviced by two or more participating HMO's.

II. Income Maintenance Provisions

Standard Filing Unit

Establishes a standard filing unit for the AFDC program.

Households Headed by Minor Parent

Requires that in order to qualify for AFDC benefits, an unmarried minor parent and her child would have to reside in the home of the minor parent's own parent or guardian, except in certain instances.

Clarification of Earned Income Definition

Clarifies current law with regard to the definition of the term "earned income".

CWEP Operation by Federal Agencies

Clarifies a provision of the 1981 Omnibus Budget Reconciliation Act which authorized the operation of Community Work Experience Programs (CWEP) by the States.

Exclusion of Child's Earnings from Gross Income Limit

Permits States to exclude the earnings of a child from the 150 percent limit on gross family income for the determination of eligibility for the AFDC program.

Adjustment for Retroactive Benefits

Provides for the collection of retroactive benefits under the Supplemental Security Income (SSI) program and social security.

Third Party Liability Collections

The Committee agreed to direct the Secretary to require State Child Support Enforcement (CSE) agencies to petition the court to include medical support as part of the child support order.

II. GENERAL REASONS FOR THE BILL

Overview

The paramount problem of fiscal policy facing the United States in the years ahead is the imbalance between projected revenues and projected expenditures. Record budget deficits are in prospect if current policy is not modified. Earlier this year, the Congressional Budget Office projected "current policy" fiscal year deficits of $196 billion in 1984, $205 billion in 1985, and $214 billion in 1986. A broad consensus has developed that a reduction in projected deficits is necessary to prevent a rise in interest rates and a premature termination of the economic recovery. Both the Senate and the House of Representatives have passed budget resolutions calling for reductions in spending and increases in revenues beginning in fiscal year 1984 (H. Con. Res. 91). This bill is presented to the Senate in response to the requirements of the budget resolution.

The Federal tax system is within the jurisdiction of the Committee on Finance, as are several of the nation's major entitlement programs—medicare, medicaid, and aid to families with dependent children (AFDC). The committee continually reviews the specifications and operation of these laws and programs in order to determine whether they are offering unintended benefits to those affected by them and whether the objectives of these laws are being achieved as efficiently as possible. This review has resulted in the committee's recommendation that the provisions of this bill should be enacted. These provisions result in cumulative spending reductions of $13.4 billion and cumulative revenue increases of $13.4 billion over the fiscal years 1984 through 1986.

Revenue Provisions

Several of the revenue provisions do not increase tax liability, but rather are designed to improve compliance or collection procedures. These include the various reporting and penalty provisions, the requirement for withholding on gains from foreign investment in U.S. real property, and the requirement that the alternative minimum tax is subject to estimated tax payment. Another group of provisions is designed to modify various requirements related to the favorable treatment of capital gains and limitations on the deductibility of capital losses, in order to insure that preferential treatment is focused on minimizing distortions of the tax system and the limits on such treatment are effective in preventing unnecessary tax avoidance. These sections include the reductions in the capital gains holding period and in the limit for deducting capital losses, the revision of the collapsible corporation rules, and the amendments dealing with stock option and commodity straddles.

Two other provisions of the bill expand the excise tax on sport fishing equipment and make related changes in the trust funds to which the resulting revenues are appropriated and, in view of the larger than expected response to the savings incentives included in the Economic Recovery Tax Act of 1981, postpone the effective date of the net interest exclusion. The last group of provisions reduces unintended benefits allowed in present law dealing with income averaging, graduated corporate tax rates, and leasing of property to tax-exempt entities. Although none of these provisions by themselves raises a large amount of revenue, together they make a significant contribution to reducing the budget deficits projected in the immediate future.

Spending Reduction Proposal

The spending provisions for the most part address Part B of medicare, the Supplemental Medical Insurance (SMI) program. In fiscal year 1984, the general fund of the U.S. Treasury will have to contribute an estimated $16.8 billion to the SMI trust fund in order to keep it solvent. That general fund obligation is expected to grow by 13.3 percent to $19 billion in fiscal year 1985.

The major provisions which affect SMI spending reductions include holding reasonable charges for physicians to prior year levels for a seven month period, establishing a fee schedule for clinical laboratory services, indexing the deductible and modifying the premium liabilities for Part B enrollees, and limiting the frequency of certain foot care services.

For the most part, the remaining health related spending provisions address the medicaid program. They increase spending ceilings for Puerto Rico and the territories, require medical support as a part of child support, extend medicaid coverage to certain pregnant women, and reduce the frequency at which physician's certify the institutional needs of nursing home patients. The nursing home patient certification provision also reduces spending for Part A of medicare, the Hospital Insurance program, while a provision delaying application of a single skilled nursing care rate to hospital-based nursing care units increases outlays skilled. Additionally, the committee has included a provision to increase the authorization level for the Maternal and Child Health Block Grant program and a number of provisions without budgetary effect which modify various elements of the medicare and medicaid programs.

Additional items were added by the Committee which deal with the Aid to Families with Dependent Children (AFDC) Program and the Supplemental Security Income (SSI) Program. For the most part, these provisions provide administrative simplification or technical clarifications for the Programs.

First, the Committee agreed to a proposal which would establish a standard filing or assistance unit for an AFDC family. A related provision would require a minor parent of an AFDC child to remain with her own parent or legal guardian whenever possible. These provisions will not only target assistance to those with limited resources, but they will also simplify State administration of the program. Two additional technical amendments were approved, as well as an amendment with negligible outlay effect. This provision

permits States to exclude the earnings of a full time student from the eligibility determination calcuation.

Second, the Committee agreed to a proposal which provides for the collection of windfall benefits from Supplemental Security Income benefits as well as from benefits paid under the Old Age Survivors and Disability Insurance programs. This provision is basically a technical correction for an amendment adopted in 1980.

III. BUDGET EFFECTS

A. Revenue Effects of Tax Provisions

The revenue provisions of the committee bill involving statutory changes are estimated to increase net budget receipts by $1.8 billion in fiscal year 1984, $4.5 billion in fiscal year 1985, and $7.1 billion in fiscal year 1986. Thus, the total revenue raised during the first three fiscal years, 1984 through 1986, equals $13.4 billion.

The table below provides detailed estimates for the tax provisions of the bill for fiscal years 1984–1988.

Estimated Revenue Effects of Revenue Provisions of the Reconciliation Recommendations of the Senate Finance Committee, Fiscal Years, 1984–88

[In millions of dollars]

Provision	1984	1985	1986	1987	1988
A. Individual Income Tax Provisions:					
1. Estimated tax payments of alternative minimum tax	557	54	45	49	52
2. Modification of income averaging	306	1,255	1,372	1,485	1,602
3. Postponement of net interest exclusion		1,024	2,858	1,892	
4. Exclusion from gross income for cancellation of certain student loans	(1)	(1)			
B. Corporate Tax Rate Change	104	177	185	190	192
C. Tax-Exempt Entity Leasing	511	1,011	1,848	3,161	5,032
D. Tax Treatment of Capital Gains and Losses	(2)	424	307	315	333
E. Excise Tax on Sport Fishing Equipment and Financing of Sport Fish Restoration and Federal Boating Safety Programs		12	13	14	14
F. Prevention of Tax Avoidance:					
1. Treatment of stock option straddles and other options	178	394	94	67	73

Estimated Revenue Effects of Revenue Provisions of the Reconciliation Recommendations of the Senate Finance Committee, Fiscal Years, 1984–88—Continued

[In millions of dollars]

Provision	1984	1985	1986	1987	1988
2. Foreign investment companies	(3)	(3)	(3)	(3)	(3)
3. Collapsible corporations	7	75	239	330	360
G. Taxpayer Compliance Provisions	33	92	170	211	232
H. Withholding on Dispositions of Foreigners of United States Real Property Interests	73	7	8	9	9
Total	1,769	4,525	7,139	7,723	7,899

[1] Loss of less than $5 million.
[2] Gain of less than $5 million.
[3] Gain of less than $10 million.

B. Effects of Spending Reduction Proposals

[Outlays in millions of dollars]

Provision	Fiscal year—			3-year total
	1984	1985	1986	
Medicare:				
1. Repeal of Limitations on Part B Premium increases	0	0	−359	−359
2. Limitation on Physician Fee Prevailing Charge Level	−320	−630	−740	1,690
3. Hepatitis B Vaccine	+2	−1	−2	−1
4. Index Part B Deductible	−50	−115	−180	−345
5. Reimbursement to Home Health Agencies for DME	−10	−20	−20	−50
6. Limitation on Certain Foot Care Services	−28	−40	−42	−110
7. Uniform Fees for Lab Services	−75	−175	−70	−320
8. Delay Implementation of Single Limit for SNFs	+10	+20	0	+30
Medicare subtotal	−471	−961	−1,413	−2,845
Medicaid:				
1. Reduce Frequency of Recertifications of SNF/ICF Patients	−8	−1	0	−9

B. Effects of Spending Reduction Proposals—Continued

[Outlays in millions of dollars]

Provision	Fiscal year—			3-year total
	1984	1985	1986	
2. Regulatory Initiative in Third Party Liability	−30	−100	−112	−242
3. Increase Medicaid Ceilings for Puerto Rico and the Territories	+20	+20	+20	+60
4. Coverage of Pregnant Women	+6	+11	+12	+29
5. Payment for Psychiatric Hospitals	+10	+10	+6	+26
Medicaid subtotal	−2	−60	−74	−136
Maternal and Child Health:				
1. Increase Authorization for Block Grant	+55	+64	+42	+161
Health subtotal	−418	−957	−1,445	−2,820
AFDC:				
1. Include all adults and children in AFDC assistance unit	−100	−135	−140	−375
2. Households headed by minor parents	−15	−20	−20	−55
3. CWEP Work for Federal Agencies	0	0	0	0
4. Clarify current law regarding order of income disregards	−18	−24	−24	−66
AFDC subtotal	−133	−179	−184	−496
SSI:				
1. Windfall benefits	−10	−16	−17	−43
Income security subtotal	−143	−195	−201	−539
Authorizations:				
1. Sport Fish Recreation Program	0	+7	+15	+22
Total all programs	−561	−1,145	−1,631	−3,337
Offsets:				
Impact of Medicare on Medicaid	−14	−20	+15	−19
Impact of Medicaid on Medicare	−25	−27	−29	−81
Impact of Medicare on Premiums	+106	+171	+184	+461
AFDC impact on: CSE	+4	+5	+5	+14
Medicaid	+51	+75	+85	+211

B. Effects of Spending Reduction Proposals—Continued

[Outlays in millions of dollars]

Provision	Fiscal year—			3-year total
	1984	1985	1986	
Impact on Food Stamps	+37	+53	+54	+144
Total offsets	+159	+257	+314	+730

IV. EXPLANATION OF REVENUE RECONCILIATION PROVISIONS

A. Individual Income Tax Provisions

1. Estimated Tax Payments of Alternative Minimum Tax (sec. 104 of the bill and sec. 6654 of the Code)

Present Law

Under present law, an individual who fails to pay an installment of estimated income tax on or before the due date generally is subject to a penalty established for interest (under sec. 6621). The penalty is computed by applying the interest rate to the amount of the underpayment of the installment for the period of the underpayment. The amount of the underpayment is the difference between the payments (including withholding) made on or before the due date of each installment and 80 percent of the total tax shown on the return for the year divided by the number of installments that should have been made. A number of exceptions to the underpayment penalty apply. Estimated tax payments of the alternative minimum tax are not required.

Reasons for Change

The committee believes that persons subject to the alternative minimum tax, as restructured by TEFRA, should be required to make current estimated payments just as individuals subject to other income taxes are required to do.

Explanation of Provision

Estimated tax payments of the alternative minimum tax will be required.

Effective Date

The provision will be effective for taxable years beginning after December 31, 1983.

Revenue Effect

This provisions will increase fiscal year budget receipts by $557 million in 1984, $54 million in 1985, $45 million in 1986, $49 million in 1987, and $52 million in 1988.

2. Modification of Income Averaging (sec. 102 of the bill and secs. 1301 and 1302(a) of the Code)

Present Law

Under present law, if an eligible individual has current year taxable income that exceeds 120 percent of average taxable income in the previous 4 years (the base period), then he or she may be eligible to elect income averaging. The amount by which the current year's taxable income exceeds 120 percent of the average base period income is termed averageable income. Individuals may not use income averaging unless averageable income exceeds $3,000. Under income averaging, the tax liability attributable to averageable income is computed by using only the marginal rates applicable to the first 20 percent of averageable income.

Reasons for Change

Although income averaging was originally intended to benefit taxpayers with either widely fluctuating income or a sharp jump in real income, many taxpayers whose income has increased merely at the rate of inflation have been eligible for income averaging in recent years.

As a result, the percentage of taxpayers using income averaging has increased substantially in recent years. This problem is magnified by indexing because indexing by itself will keep marginal tax rates constant for an individual whose increases in income are entirely attributable to inflation. Thus taxpayers may receive a double benefit from indexing and income averaging. The committee believes that such a double benefit is inappropriate. Furthermore, the 23-percent across-the-board reduction in marginal tax rates enacted in 1981, including a top rate of 50 percent on ordinary income and 20-percent on long-term capital gains greatly reduce the need for an income averaging provision as generous as that provided by present law.

Explanation of Provision

The bill provides that averageable income is defined as the amount by which the taxable income for the current year exceeds 140 percent, instead of 120 percent as under present law, of the average base period income. By raising the threshold for income averaging, only those taxpayers with an unusual increase in income will receive a benefit from using the method, rather than taxpayers with more normal increases in income who benefit under present law.

Effective Date

This provision will apply to taxable years beginning after December 31, 1983.

Revenue Effect

This provision will increase fiscal year budget receipts by $306 million in 1984, $1,255 million in 1985, $1,372 million in 1986, $1,485 million in 1987 and $1,602 million in 1988.

3. Postponement of Net Interest Exclusion (sec. 103 of the bill and sec. 128 of the Code)

Present Law

Background

In the Economic Recovery Tax Act of 1981 (ERTA), Congress repealed the $200 ($400 on a joint return) interest and dividend exclusion for taxable years beginning after 1981.[1] Congress also established a temporary program of tax-exempt certificates (generally known as All Savers Certificates). All Savers Certificates were issuable by qualified savings institutions from September 30, 1981, through December 31, 1982. A lifetime exclusion from gross income of $1,000 ($2,000 in the case of a joint return) of interest earned on qualified tax-exempt certificates was provided.

ERTA also liberalized the requirements governing eligibility for and deductibility of contributions to individual retirement accounts (IRAs).[2]

Net interest exclusion

For taxable years beginning after 1984 (i.e., one year after the expiration of the All-Savers Certificate program), ERTA provides for an exclusion of 15 percent of net interest received up to $3,000 of net interest ($6,000 on a joint return). Net interest is generally defined as eligible interest received by the taxpayer in excess of the amount of interest payments by the taxpayer for which an income tax deduction is allowed. Eligible interest generally includes interest paid on deposits in banks and thrift institutions, corporate debt in registered form or in a form generally sold to the public, United States Government debt, certain Federally sponsored participation trusts, and certain amounts held by life insurance companies.

Mortgage interest and trade or business interest are not taken into account to reduce eligible interest income. For this purpose, mortgage interest is interest paid on debt incurred to acquire, construct, reconstruct, or rehabilitate property the taxpayer uses primarily as a dwelling. The Technical Corrections Act of 1982 clarifies that an individual who does not itemize deductions will not be required to reduce eligible interest income by interest payments that the individual makes, and that a person itemizing deductions will be required to reduce eligible interest income by no more than the amount of his or her excess itemized deductions.

Reasons for Change

Congress enacted the net interest exclusion for taxable years beginning after 1984 because it believed that a permanent savings incentive based on net savings should replace the temporary All Savers Certificate program. However, in light of the unexpected popularity and high level of use of IRAs as a savings device following the 1981 liberalization of the IRA tax rules, the committee be-

---

[1] For subsequent years, the $100 dividend exclusion previously in effect was reinstated, amended to permit an exclusion of up to $200 to be claimed on a joint return without regard to which spouse actually receives the dividend.

[2] *See* ERTA, section 311; H.R. Rep. No. 201, 97th Cong., 1st Sess. 132-37 (1981); S. Rep. No. 144, 97th Cong., 1st Sess. 111-15 (1981).

lieves that Congress should reconsider the need for the net interest exclusion as a savings incentive.

The committee continues to believe that savings in the country should be encouraged by tax incentives. On the other hand, revenues lost by those tax incentives will have the effect of increasing Federal deficits. In this regard, revenue losses from the ERTA liberalization of the IRA tax rules have been significantly larger than projected. In light of these unexpectedly large revenue losses, the committee believes that present fiscal restraints warrant postponement of additional tax incentives for savings.

In addition, the committee is concerned that certain tax benefits for savers may not induce individuals to significantly increase their savings. For example, one effect of the tax benefits for IRAs was to encourage taxpayers to convert existing savings into IRAs, thereby significantly increasing the revenue loss associated with the provision without significantly increasing net savings.

Accordingly, the committee believes that the net interest exclusion should be postponed for two years at which time the committee expects that the fiscal position of the Federal Government will permit institution of the net interest exclusion provision. The two year delay also will provide additional time to study the effect of net interest exclusion on savings.

Explanation of Provision

The bill postpones the effective date of the net interest exclusion enacted in ERTA for two years. Under the bill, the net interest exclusion will be available for taxable years beginning after 1986 rather than for taxable years beginning after 1984.

Effective Date

This provision of the bill will become effective on the date of enactment.

Revenue Effect

This provision will increase fiscal year budget receipts by $1,024 million in 1985, $2,858 million in 1986, and $1,892 million in 1987.

4. Exclusion from Gross Income for Cancellation of Certain Student Loans (Sec. 105 of the bill)

Present Law

Under present law, gross income means all income from whatever source derived, including income from discharge of indebtedness (Code sec. 61(11)). However, subject to certain limitations, gross income does not include any amount received as a scholarship or a fellowship grant (sec. 117(a)). With the exception of certain Federal grants for tuition, an amount paid to an individual to enable him or her to pursue studies or research does not qualify as a scholarship or fellowship grant if the amount represents compensation for past, present, or future employment services or if the studies or research are primarily for the benefit of the grantor (Treas. Reg. sec. 1.117–4(c)).

Under certain student loan programs established by the United States and by State and Local governments, all or a portion of the indebtedness may be forgiven if the student performs certain services for a period of time in certain geographical areas pursuant to conditions in the loan agreement. In 1973, the Internal Revenue Service ruled on a State medical education loan scholarship program under which part of the loan was forgiven if the recipient practiced medicine in a rural area of the State. The Service determined that amounts received under the program were included in the recipient's gross income to the extent that repayment of the loan was no longer required (Rev. Rul. 73–256, 1973–1 C.B. 56).

Section 2117 of the Tax Reform Act of 1976 (P.L. 94–455) provided that, in the case of loans forgiven prior to 1979, no amount was to be included in gross income by reason of the discharge of all or part of the indebtedness of the individual under certain student loan programs. The exclusion applied to a discharge pursuant to a provision of indebtedness is to be discharged if the individual works for a certain period of time in certain professions in certain geographical areas or for certain classes of employers. The exclusion applied only to loans made by the United States or an instrumentality or agency thereof or by a State or loan government, either directly or pursuant to an agreement with the educational institution. The primary purpose of the exclusion was to assist those States and cities that have experienced difficulties in attracting doctors, nurses, and teachers to serve in certain rural and low-income urban areas.

The Revenue Act of 1978 extended the exclusion for certain student loan cancellations to loans forgiven prior to January 1, 1983.

Reasons for Change

The committee believes that the exclusion for income for cancellation of certain student loans serves an important purpose in encouraging doctors, nurses, and teachers to serve in rural and low-income areas, and should therefore be extended. The committee further believes that the exclusion should be broadened to include loans made by a public benefit hospital corporation which is treated as a public entity under applicable State law.

Explanation of Provision

The bill extends, for an additional two years, the exclusion from income for cancellation of certain student loans provided by the Tax Reform Act of 1976 and previously extended by the Revenue Act of 1978. Accordingly, no amount is to be included in gross income by reason of the discharge, prior to January 1, 1985, of all or part of a student loan of the type described in the 1976 Act. The bill also broadens the exclusion provided by the 1976 Act to include loans made by a tax-exempt (sec. 501(c)(3)) public benefit hospital corporation which has assumed control over a State, county, or municipal hospital and whose employees have been deemed to be public employees under State law (including loans made directly by such corporation or pursuant to an agreement with the educational institution).

Effective Date

The provision is effective for loans forgiven on or after January 1, 1983, and prior to January 1, 1985.

Revenue Effect

This provision is estimated to reduce fiscal year budget receipts by less than $5 million per year in fiscal years 1984 an d1985.

B. Phaseout of Graduated Rate for Large Corporations

(Sec. 108 of the bill and sec. 11 of the Code)

Present Law

Corporate taxable income is subject to tax under a five-step graduated tax rate structure. The top corporate tax rate is 46 percent on taxable income over $100,000.

The corporate taxable income brackets and tax rates are presented in the following table:

Taxable income:	*Tax rate*
0–$25,000	15
$25,000–$50,000	18
$50,000–$75,000	30
$75,000–$100,000	40
Over $100,000	46

Reasons for Change

The graduated corporate tax rates were added in 1978 to ease the tax burden on small business. However, large corporations, as well as small corporations, are entitled to these benefits. The committee believes that large corporations should not be able to take advantage of this small business provision. Therefore the benefits of the graduated tax rates are generally eliminated for any corporation with large income.

Explanation of Provision

An additional 5-percent corporate tax will be imposed on a corporation's taxable income in excess of $1 million. However, the maximum additional tax will be $20,000.

For purposes of applying these rules, the component members of a controlled group of corporations (under section 1561) will be treated as one corporation.

Effective Date

The provision will apply to tarable years beginning after December 31, 1983.

Revenue Effect

This provision will increase fiscal year budget receipts by $104 million in 1984, $177 million in 1985, $185 million in 1986, $190 million in 1987 and $192 million in 1988.

C. Tax-Exempt Entity Leasing

Present Law

Summary

Under present law, the rules for determining who is entitled to the tax benefits associated with the ownership of property generally are not written in the Internal Revenue Code. Rather, they are embodied in a series of court cases and revenue rulings and revenue procedures issued by the IRS. Essentially, these rules focus on the economic substance of a transaction, not its form, for determining who is entitled to the tax benefits of the ownership of property. Thus, in a purported lease or similar arrangement, the person claiming ownership for Federal income tax purposes must show that he has sufficient economic indicia of ownership.

In general, the tax benefits of ownership of property include depreciation or accelerated cost recovery deductions and investment tax credits. Generally, ACRS or other depreciation deductions and investment credits are allowed only for property used for a business or income-producing purpose. The accelerated cost recovery system generally permits taxpayers to depreciate qualifying property on an accelerated basis over relatively short periods. For most property, the ACRS recovery period is shorter than the actual useful life of the property. Investment credits permit taxpayers to reduce their tax liability by a percentage of their investment in eligible property. Eligible property includes certain depreciable personal property. Special rules apply to certain energy property and to certain improvements to buildings at least 30 years old.

As a general rule, governmental units and tax-exempt organizations are not entitled to ACRS or other depreciation deductions or investment credits for property owned by them. Moreover, no investment credit is allowed for property used (though not owned) by a tax-exempt organization in its exempt function or by a governmental unit (nontaxable use restriction). The nontaxable use restriction does not affect the allowance of ACRS deductions and certain other tax benefits.

Property used by a foreign government or person is not subject to the nontaxable use restriction. However, if the property is used predominantly outside the United States (foreign-use property), then, in general, ACRS deductions are reduced and no investment credit is allowed.

The traditional reasons for leasing stem from tax, accounting, and a variety of business considerations. Tax-exempt organizations and governmental units have leased equipment for many of the same reasons as taxable entities. The recent increase in leasing and similar arrangements is due, in part, to budgetary limitations on the purchase of property and, in the case of some State and

local governments, limitations on their ability to issue tax-exempt bonds. From a tax perspective, leasing allows certain tax benefits to flow through (in the form of reduced rents) to nontaxable entities or thrift institutions that are not eligible for such benefits on their own account. In some cases, the reasons for arranging a transaction as a service contract or in some other form stem from a desire to avoid the nontaxable use restriction on the investment credit or other Federal income tax rules.

What follows is a description of the present-law rules governing the determination of ownership of property for Federal income tax purposes, in the context of purported leases or similar arrangements, and a description of the nontaxable use restriction on the investment credit. The rules governing ACRS and the investment credit for foreign-use property and other rules are also discussed.

The ownership issue

Overview

The determination of the Federal income tax ownership of property requires a case-by-case analysis of all facts and circumstances. Although the determination of ownership is inherently factual, a number of general principles have been developed in court cases, revenue rulings, and revenue procedures.

In general, both the courts and the IRS focus on the substance of the transaction rather than its form. The courts do not disregard the form of a transaction simply because tax considerations are a significant motive, so long as the transaction also has a bona fide business purpose and the person claiming tax ownership has sufficient burdens and benefits of ownership.

In general, for Federal income tax purposes, the owner of property must possess meaningful burdens and benefits of ownership. The lessor must be the person who suffers, or benefits, from fluctuations in the value of the property. Thus, lease treatment is denied, and the lessee is treated as the owner, if the lessee has the option to obtain title to the property at the end of the lease for a price that is nominal in relation to the value of the property at the time the option is exercisable (as determined at the time the parties entered into the agreement) or which is relatively small when compared with the total lease payments to be made.

Where the lessor's residual value in the property is nominal, the lessor is viewed as having transferred full ownership of the property for the rental payments. Where the purchase option is more than nominal but relatively small in comparison with fair market value, the lessor is viewed as having transferred full ownership because of the likelihood that the lessee will exercise the option. Furthermore, if the lessor has a contractual right to require the lessee to purchase the property at the end of the lease (a put), the transaction could be denied lease treatment because the put eliminates the lessor's risk of loss in value of the residual interest and the risk that there will be no market for the property at the end of the lease.

Objective guidelines used in structuring transactions

To give taxpayers guidance in structuring leveraged leases (i.e., leases in which the property is financed by a nonrecourse loan from a third party) of equipment, the IRS issued Revenue Procedure 75-21, 1975-1 C.B. 715, and a companion document, Revenue Procedure 75-28, 1975-1 C.B. 752 (the guidelines). If the requirements of the guidelines are met and if the facts and circumstances do not indicate a contrary result, the IRS generally will issue an advance letter ruling that the transaction is a lease and that the lessor is the owner for Federal income tax purposes.

The guidelines are not by their terms a definitive statement of legal principles and are not intended for audit purposes. Thus, if all the requirements of the guidelines are not met, a transaction might still be considered a lease if, after considering all the facts and circumstances, the transaction is a lease under the general principles described above.

The specific requirements for obtaining a ruling under the guidelines are as follows:

1. *Minimum investment.*—The lessor must have a minimum 20 percent unconditional at-risk investment in the property.

2. *Purchase options.*—In general, the lessee may not have an option to purchase the property at the end of the lease term unless, under the lease agreement, the option can be exercised only at fair market value (determined at the time of exercise). That rule precludes fixed price purchase options, even at a bona fide estimate of the projected fair market value of the property at the exercise date.

3. *Lessee investment precluded.*—Neither the lessee nor a party related to the lessee may furnish any part of the cost of the property.

4. *No lessee loans or guarantees.*—As a corollary to the prior rule, the lessee must not loan to the lessor any of the funds necessary to acquire the property. In addition, the lessee must not guarantee any loan to the lessor.

5. *Profit and cash flow requirements.*—The lessor must expect to receive a profit and have a positive cash flow from the transaction independent of tax benefits.

6. *Limited use property.*—Under Revenue Procedure 76-30, 1976-2 C.B. 647, property that can be used only by the lessee (limited use property) is not eligible for leveraged lease treatment.

Nontaxable use restriction on the investment credit

General rule

Property that is "used by" a tax-exempt organization in an exempt function or by a governmental unit generally is ineligible for the investment credit (secs. 48(a)(4) and 48(a)(5)), including the investment credit for energy property. For this purpose, a governmental unit includes the United States government, any State or local government, most international organizations, and any instrumentality of the foregoing. A tax-exempt organization is almost any organization exempt from Federal income tax, such as a charitable or educational organization.

To determine whether property is subject to the nontaxable use restriction, it is first necessary to evaluate the economic substance of the transaction under the general principles for determining who is the tax owner of property.[3]

Under the nontaxable use restriction, the investment credit is unavailable with respect to property that is treated for Federal income tax purposes as being owned by a governmental unit or a tax-exempt organization for use in its exempt function. In addition, property leased to a governmental unit or a tax-exempt organization for use in its exempt function is generally subject to the nontaxable use restriction. However, in addition to several statutory exceptions to the nontaxable use restriction, one court has held (and the IRS has ruled) that the investment credit can be claimed where the governmental unit essentially has contracted for a service, to be provided by the owner of property, rather than for the use of the property itself.

Statutory exceptions to the nontaxable use restriction

Tax-exempt organizations.—Under present law, certain farmers' cooperatives (which are considered exempt from tax even though they are subject to the rules of subchapter T, relating to cooperatives and their patrons) are excluded from the restriction on use by a tax-exempt organization. Also, the credit is allowed for property used by a tax-exempt organization in a taxable unrelated trade or business.

Foreign governmental units.—Although international organizations generally are subject to the restriction, property used by the International Satellite Consortium, the International Maritime Satellite Organization, and any successor organizations is excluded from the restriction on governmental use. Foreign governments and possessions of the United States are not subject to the restriction. Thus, a computer leased to the United States Government is denied the credit, but a computer leased to a foreign embassy located in the United States is allowed the credit.

Rehabilitated buildings.—Under present law, rehabilitation tax credits are available for qualified rehabilitation expenditures incurred for older buildings leased to tax-exempt organizations or to governmental units.

Foreign persons.—Property used by foreign persons is not subject to the nontaxable use restriction. However, special rules (discussed below) apply if the property is "used predominantly outside the United States."

Casual or short-term lease exception

Under Treasury regulations, there is an exception to the nontaxable use restriction for property that is leased on a "casual or short-term basis" (Treas. Reg. sec. 1.48-1(j) and (k)).

---

[3] Rev. Rul. 68-590, 1968-2 C.B. 66. Revenue Ruling 68-590 involved arrangements between a taxable corporation and a political subdivision of a State providing for the tax-exempt financing, construction, and operation of an industrial project. The IRS did not apply the nontaxable use restriction even though the governmental unit held legal title under a sale-and-leaseback. Rather, the IRS held that the corporation was the tax owner of the property. The IRS reasoned that, in view of the economic substance of the arrangement, the sale-leaseback arrangement was nothing more than a security device for the protection of the holders of the tax-exempt bonds.

Casual leases.—The term "casual lease" has been interpreted to mean a lease that lacks the formalities inherent in a written lease.[4] Another example of a casual lease might be the lease of an automobile from a car rental company by a governmental employee traveling on governmental business.[5]

Short-term leases.—The exception for short-term leases has been recognized as a means of allowing the government to fulfill an unforeseen or extraordinary need for obtaining the short-term use of property from the private sector, without causing the taxpayer to lose the credit.[6] Thus, property not ordinarily intended for lease to a tax-exempt organization or governmental entity may be leased under the exception for a short period in unforeseen or extraordinary circumstances.

In determining whether the exception for short-term leases applies, the courts have rejected the contention that the relevant consideration is whether the nonqualifying use constitutes a substantial portion of the useful life of the property.[7] The courts have also rejected the position that short-term use should be determined on the basis of the minimum legally enforceable period of a lease.[8]

Service contract exception

Internal Revenue Service rulings.—Under Treasury regulations (sec. 1.48-1(j) and (k)), property used by a governmental unit or tax-exempt organization means property owned by or leased to one of those nontaxable entities. In Revenue Ruling 68-109, 1968-1 C.B. 10, the IRS ruled that property provided to a governmental unit as an integral part of a service is not "used by" the government within the meaning of section 48(a)(5).

Revenue Ruling 68-109 involved communications equipment installed by a public utility on the premises of governmental units. In ruling that the taxpayer's agreements with its customers were not sales or leases, but rather service contracts, the IRS relied on the fact that the taxpayer retained all ownership in and possession and control over the equipment. The IRS also focused on the fact that the communications equipment was part of an integrated network used to render services to the customer, not property placed with a user to allow it to provide services to itself.

The IRS has issued a number of other rulings, including private rulings,[9] interpreting the service contract exception. For example, the investment credit has been denied in situations involving trucks operated under a service contract by government employees (Rev. Rul. 72-407, 1972-2 C.B. 10) and school buses operated by a private party under contract with a local school district (LTR 8104001 (February 27, 1980)). However, in LTR 8217040 (January 27, 1982), the IRS allowed the investment credit in a situation involving a time charter of a vessel to the Federal government. The

---

[4] See, *Xerox Corporation v. United States*, 656 F.2d 659 (Ct. Cl. 1981).

[5] *Id.*

[6] *World Airways, Inc. v. Commissioner*, 564 F.2d 886 (9th Cir. 1977), *aff'g* 62 T.C. 786 (1974).

[7] *World Airways Inc. v. Commissioner*, 62 T.C. 786 (1974), *aff'd*, 564 F.2d 886 (9th Cir. 1977).

[8] Thus, the mere fact that a lease contains a cancellation clause will not result in application of this exception. *Xerox Corporation v. United States*, 656 F.2d 659 (Ct. Cl. 1981); *Stewart v. U.S.*, 77-2 U.S.T.C. 9648 (D.Neb. 1977).

[9] A private ruling is not binding as precedent on the IRS with respect to taxpayers other than the taxpayer who received the ruling, or the courts.

IRS ruled that the taxpayer could claim an investment credit for the vessel based on the taxpayer's representations that the taxpayer bore the risk of loss with respect to the vessel, the taxpayer had to retain possession and control over the vessel, the taxpayer was required to provide maintenance and secure insurance for the vessel, the taxpayer had to furnish and control the crew of the vessel, and the time charter transferred no legal interest in the vessel to the Federal government.

The case law.—The only judicial decision dealing with the service contract exception to the nontaxable use restriction is *Xerox Corporation* v. *United States*, 656 F.2d 659 (Ct. Cl. 1981). In *Xerox*, a manufacturer provided duplicating machines to the Federal government. The IRS had issued a revenue ruling involving the same basic facts as in *Xerox* that held that the agreements were leases (Rev. Rul. 71-397, 1971-2 C.B. 63). The Court of Claims rejected the taxpayer's contention that its agreements were short-term leases, which are eligible for an exception to the governmental use restriction. However, the court held that the machines were eligible for the investment credit because they were provided as an integral part of a service contract.

Essentially, the Court of Claims based its decision on the IRS's own formulation of the service contract exception, as set forth in the holdings of published and private rulings (other than Rev. Rul. 71-397). The court rejected the government's contention that the service contract exception cannot ever apply where the customer's own personnel operate the machines, because this factor was present in the first ruling applying the exception (i.e., Rev. Rul. 68-109). The court emphasized that *Xerox* was not a case in which the cost or value of the property dominated the price of the total arrangement. The court also noted that, conceivably, its decision would have been different if Treasury regulations had formulated the precise confines of the service contract exception.

Although the published and private rulings do not articulate any single test for use in determining whether an agreement is a service arrangement or a lease, the court felt that the factors deemed common to service contracts in those rulings related to two broad areas of inquiry: (1) the nature of the possessory interest retained by the taxpayer and (2) the degree to which the property supplied is a component of an integrated operation in which the taxpayer has other responsibilities.

In holding that the interest conveyed to the customer was not sufficient to constitute a leasehold interest, the *Xerox* court focused on the following factors drawn from the IRS rulings in which a service contract was held to exist: (1) the taxpayer retained ownership of the machines, (2) the taxpayer decided whether to repair, replace, or alter the machines, and the customer was prohibited from altering or moving the machines, (3) the taxpayer bore the cost of adjustments, repairs, and replacements, (4) the taxpayer was responsible for loss or damage, except in the case of the customer's negligence, and (5) the customer could cancel upon 15 days notice.

Finally, in holding that the taxpayer's contractual arrangements could reasonably be deemed to be within the purpose of the investment credit, the court focused on the fact that the taxpayer manufactured machines for all customers, not just the government, and

that governmental use represented only 5 or 6 percent of the taxpayer's machines.

Foreign-use limitations

Overview

Property "used predominantly outside the United States" is subject to reduced ACRS deductions and is not allowed the investment credit (secs. 168(f)(2) and 48(a)(2)).

In general, property "used predominantly outside the United States" means property used outside the United States for more than half of the taxable year. However, there are a number of exceptions to this general rule. For example, communications satellites are excepted from the rules for foreign-use property. U.S.-flag vessels operated in the foreign or domestic commerce of the United States are excepted, as are aircraft registered by the Federal Aviation Agency and operated to and from the United States[10] and aircraft operated under contract with the United States, even if operated by a foreign airline. Special rules are also provided for certain rolling stock, drilling rigs, motor vehicles, containers, submarine cable, and other property.

ACRS deductions

The recovery period for computing ACRS deductions for recovery property used predominantly outside the United States is equal to the present class life (mid-point life) for the property, as of January 1, 1981, under the prior law ADR system. For personal property for which there is no ADR mid-point life as of January 1, 1981, a 12-year recovery period must be used. The determination of useful lives based on facts and circumstances is not permitted. The owner of foreign-use personal property generally is allowed to use the 200-percent declining balance method of depreciation for the early years of the recovery period and the straight-line method for later years.

For foreign real property (including all components of a building), the recovery period is 35 years. The owner of foreign real property is generally allowed to use the 150-percent declining balance method for the early years of the recovery period, switching to the straight-line method in later years.

In the case of foreign-use personal property or foreign real property, the straight-line method of depreciation can be used in lieu of the prescribed accelerated methods. In addition, for foreign-use personal property, the taxpayer may elect the straight-line method over one of the longer recovery periods allowed for domestic property (but the period elected may not be shorter than the ADR mid-point life, or, for property without an ADR mid-point life as of January 1, 1981, 12 years). For foreign real property, the taxpayer may elect to use the straight-line method over a recovery period of 45 years (instead of 35 years).

---

[10] The IRS has ruled that a plane returning to the United States only once every two weeks qualifies as being operated to and from the United States. Rev. Rul. 73-367, 1973-2 C.B. Furthermore, an airplane can be leased for temporary use outside the United States without any investment credit recapture. Under section 47(a)(7)(A), 3 1/2 years qualifies as temporary use for this purpose.

Other limitations

Thrift institutions

Certain provisions of present law limit the investment credit with respect to property owned by organizations to which section 593(a) applies (thrift institutions) to 50 percent of the investment credit otherwise available (sec. 46(e)(2)(A)). Certain such organizations have realized up to 100 percent of the investment credit by leasing rather than buying property.

Public utility property

Special depreciation and investment credit rules apply to "public utility property" (e.g., sec. 168(c)(2)(E) and sec. 46(f)(5)). Public utility property generally includes property used predominantly in the trade or business of the furnishing or sale of utility services subject to rate regulation (e.g., sec. 167(*l*)(3)(A) and sec. 46(c)(3)). While property leased to a public utility, by virtue of the lease, constitutes public utility property, property used to provide services to the public utility under a service contract or similar arrangement may not.

Reasons for Change

Overview

The committee believes that reform of the tax law is essential, insofar as it relates to property used by tax-exempt entities under a lease, a lease formulated as a service contract, or other similar arrangements. When tax-exempt entities use property under these arrangements, they pay reduced rents that reflect a pass-through of investment tax incentives from the owner of the property. Tax-exempt entities thereby benefit from investment incentives for which they do not qualify directly, and effectively gain the advantage of taking income tax deductions and credits while having no corresponding liability to pay any tax on income from the property. In this way, investment incentives that were intended to reduce the tax on taxable entities have been turned into unintended benefits for tax-exempt entities. The benefits are equivalent to an open-ended spending program, operated within the tax system, that increases the Federal deficit, encourages tax-exempt entities to dispose of the assets they own and forego control over the assets they use, disorders public budgeting processes, and feeds a popular perception that the tax system is open to manipulation.

The committee is greatly concerned about these problems, the scale of which has been magnified by the recent surge in leasing to tax-exempt entities and other arrangements devised to transfer tax benefits to them. In response, the committee bill restricts tax benefits for property used by tax-exempt entities so that the Federal tax outflow will be eliminated and tax-exempt entities will be able to lease property on the same tax-free basis as they can purchase it.

Background

In 1962, Congress first enacted the investment tax credit for certain property used in a trade or business or for the production of income. The purpose of the credit is to reduce the income tax liabil-

ity of taxpayers and thereby encourage their purchase and use of capital goods. When enacting the investment credit, Congress expressly disallowed it for property used by governmental units and tax-exempt organizations, which of course generally have no income tax liability to reduce. However, the provision was necessary to prevent those tax-exempt entities from indirectly gaining—through leasing, for example—the benefits of both tax-exemption and the investment credit. This policy has been continued to the present. It is grounded in the fundamental principle that the tax system exists to collect tax from taxable entities, not to make payments to tax-exempt entities.

The committee believes that the policy of providing tax-reducing incentives to those who are subject to the income tax and denying them to those who are not subject to the income tax should be maintained and that three major amendments are needed to improve its application. The amendments relate to (a) accelerated depreciation deductions, (b) transactions structured to avoid the present denial of the investment credit, and (c) the treatment of foreign tax-exempt entities.

Accelerated depreciation deductions

Over the last two decades, Congress has acted to accelerate cost recovery (depreciation) deductions for property used in a trade or business or for the production of income. The introduction of the Asset Depreciation Range System in 1971 and the enactment of the Accelerated Cost Recovery system in 1981 were two significant steps in that direction. The purpose of accelerating cost recovery deductions is to reduce the income tax liability of taxpayers in order to encourage their purchase and use of capital goods. Taking into account the time value of money, accelerated deductions reduce the present value of tax to be paid by deferring payment to later years.

The cumulative effect of legislation relating to cost recovery allowances is that these deductions currently operate, like the investment credit, as a significant investment incentive, by reducing the value of the tax that would otherwise be imposed on the investment. However, present law does not generally deny the benefits of accelerated cost recovery for property leased to tax-exempt entities. As a result, the transfer of benefits to these entities through the tax system that Congress acted to prevent with respect to the investment credit is now occurring due to accelerated depreciation deductions. Therefore, the committee bill provides for less rapid write-offs of property used by tax-exempt entities, such that the Federal tax outflow will be eliminated and tax-exempt entities will be able to lease property on the same tax-free basis as they can purchase it.

Transactions structured to avoid investment credit restrictions

The committee understands that the value of the investment credit is sufficiently great to have prompted attempts to structure transactions in a form other than a lease, such that property used by a tax-exempt entity (or a public utility or other person) or dedicated primarily to its use will nevertheless qualify for the credit (or other tax benefits). The committee is concerned that Congress has

not provided statutory guidance for determining when property is in substance used by a tax-exempt entity or other persons. Therefore, the committee bill provides criteria for this purpose, so that the economically insubstantial restructuring of a lease as a service contract or similar arrangement will not result in unintended, preferential tax treatment. For the same purpose of averting unintended results, the committee bill provides rules to prevent the use of leasing to convey the benefit of the full investment credit to thrift institutions, which are eligible for only a partial credit when they purchase property.

In addition, the committee is concerned about the excessive tax benefits that are currently available for amounts spent to rehabilitate buildings used by tax-exempt entities. Rehabilitation tax credits are not available when tax-exempt entities themselves make rehabilitation expenditures because these entities are not subject to income tax. However, the benefit of these credits can be passed through to tax-exempt entities when they use rehabilitated property under a lease or a similar arrangement. The committee believes it is necessary, therefore, to extend the current policy of denying investment credits for personal property used by tax-exempt entities to deny rehabilitation credits for real property used by tax-exempt entities.

Foreign tax-exempt entities

The present law denial of investment credit for property used by tax-exempt entities is incomplete because it does not apply to substantial amounts of certain types of property leased to foreign governments and other foreign persons who are not subject to Federal income tax. Although the committee believes that tax benefits for property used by foreign tax-exempt entities should be scaled back from present levels, it also believes that not all of the tax incentive for those entities to lease should be eliminated. The committee is well aware that American producers compete in international markets against foreign producers who benefit from measures their governments have taken to stimulate exports. The committee believes that the lower rents made possible by lessors' tax benefits are effective in encouraging the foreign use of American-made products. Therefore, the committee bill reflects the policy that a portion of the current tax incentive for foreign entities to lease should be retained.

Additional reasons

The committee has additional reasons for believing that the tax benefits (in excess of tax exemption itself) currently available to tax-exempt entities through leasing should generally be eliminated.

First, the Federal budget is in no condition to sustain the substantial revenue loss, which will certainly increase as more and more tax-exempt entities, financial entities, and tax-oriented investors learn how to take advantage of the tax system in that way. Nothing is accomplished to reduce budget deficits when spending cuts are matched or exceeded by revenue losses. These losses are

especially large in transactions involving debt-financed property.[11] The investment credit, ACRS deductions, and interest deductions for debt-financed property can be combined to produce tax write-offs the present value of which exceeds the income derived from the property. In that event, the investor's after-tax return consists in part of a negative tax, and a Federal revenue loss results by the amount that the negative tax exceeds the income tax paid on the interest income received by the lender.

Second, the committee is concerned about possible problems of accountability of governments to their citizens, and of tax-exempt organizations to their clienteles, if substantial amounts of their property should come under the control of outside parties solely because the Federal tax system makes leasing more favorable than owning. The committee is convinced that the tax system should not encourage tax-exempt entities to dispose of the assets they own or to forego control over the assets they use.

Third, the committee believes that Federal aid to tax-exempt entities (above and beyond tax exemption) should be made by appropriations rather than by tax benefit transfers paid through the tax system. The tax benefits in leasing and purported service contracts are open-ended and hence uncontrollable in amount and composition, whereas appropriations are limited and adjustable to current priorities from year to year. Moreover, tax benefits appear in the Federal budget only as reduced tax collections, unassociated with any particular public purpose. Thus, with Federal aid conveyed through the tax system, it is very difficult to discover what tax-exempt purposes have been federally assisted, by how much they have been assisted, and whether the assistance has been rendered in ways consistent with other objectives of public policy. These matters can be known, debated, and decided in the appropriations process.

Fourth, the committee is concerned about waste of Federal revenues. Although under present law tax benefits exist to be shared by the user of property and the owner, there is no assurance that the user will be the prime beneficiary. For example, when a substantial portion of the benefit is retained by lawyers, investment bankers, and investors, the Federal revenue loss becomes more of a gain to financial entities than to tax-exempt users. In proportion to that inefficiency, the Treasury loses more than $1 to provide $1 of aid to tax-exempt users through leasing, whereas the aid could be provided on a dollar-for-dollar basis through appropriations. This problem exists within the Federal government also. To the extent that a Federal agency as lessee pays rents that do not reflect a full pass-through of the lessor's income tax benefits, the Federal government pays more to lease an asset than it would to buy it.

Fifth, the committee stresses the need to sustain popular confidence that the tax system is generally working correctly. A system which entices Federal agencies not to own their essential equipment, nor colleges their campuses, nor cities their city halls, and which also rewards taxpayers who participate in such transactions with a lighter tax, risks eroding that confidence.

---

[11] With respect to tax benefits for debt-financed property, see Joint Committee on Taxation staff pamphlet "Description of S. 1564 Relating to Tax Treatment of Property Leased to Tax-Exempt Entities" (JCS-34-83).

Explanation of Provisions

(Secs. 131–132 of the Bill and Secs. 48 and 168 of the Code)

1. Overview

In general, the committee bill reduces the tax benefits that would otherwise be available for property used by tax-exempt entities or organizations described in section 593(a) (thrift institutions). The bill defines the term "tax-exempt entity" to include Federal, State, local, and foreign governments, possessions of the United States, international organizations, certain instrumentalities of the foregoing, and certain foreign persons, as well as most organizations that are exempt from Federal income tax or were exempt at any time within a prescribed 5-year period.

For all Federal income tax purposes, the bill also provides criteria for use in determining whether an arrangement characterized by the parties as a "service contract" or carrying some other label should be treated as a lease to the tax-exempt entity or other service recipient. However, the bill creates no inferences regarding the present-law treatment of purported service contracts.

To the extent a rehabilitated building is tax-exempt use property, rehabilitation credits are denied.

Special rules are provided for certain short-lived property, property subject to short-term leases, and certain other property.

Present-law rules for determining the owner of property for income tax purposes are unchanged. Thus, the bill leaves open the possibility that a tax-exempt entity or other user could be treated as the owner of property under a purported lease, service contract, or other arrangement. The bill creates no inferences regarding who under present law should be treated as the tax owner of property involved in such a transaction.

2. Definition of Tax-Exempt Entity

Under the bill, the term "tax-exempt entity," for purposes of both the depreciation and investment credit provisions, includes the United States, any State (including the District of Columbia) or local governmental unit, any possession of the United States (including Puerto Rico), and any agency or instrumentality of any of the foregoing (other than any agency or instrumentality of the United States or any State or local governmental unit all the income of which, if any, is fully subject to United States income tax).

The term also includes any organization, other than a farmers' cooperative described in section 521, that is exempt from United States income tax and, except as indicated below, any organization (and any predecessor organization engaged in substantially similar activities) that was exempt from United States income tax (other

than by virtue of section 521) at any time during the 5-year period ending on the date the property involved is first used by such organization. However, the bill does not treat property owned by any such former tax-exempt organization as tax-exempt use property.

For example, assume that a tax-exempt hospital has historically leased or owned property which is not short-lived property for use in carrying out its tax-exempt function. On January 15, 1984, the hospital creates a wholly-owned taxable subsidiary to lease property which is not short-lived property and provide services to the hospital of a kind the hospital used to provide services for itself. Any such property leased by the subsidiary any time prior to January 15, 1989, will be tax-exempt use property.

An organization which was tax-exempt under section 501(c)(12) (relating to certain cooperatives) at any time during the 5-year period ending on the date the property involved is first used by such cooperative will not be treated as a tax-exempt entity if it makes an election that it (and any successor organization which is engaged in substantially similar activities) will remain taxable for the period beginning with the taxable year the property is placed in service and ending with the 15th taxable year after the expiration of the recovery period of such property. Once made, any such election, which is to be made in the time and manner prescribed by regulations, will be irrevocable.

In addition, the term "tax-exempt entity" includes any foreign government, any international organization, any agency or instrumentality of either of the foregoing, and any other person who is not a United States person, but only with respect to property 20 percent or less of the gross income, if any, derived by the foreign lessee from the use of which is subject to United States income tax in the hands of the foreign lessee. In determining whether the 20-percent threshold is satisfied, the portion of the gross income derived by the foreign lessee from the use of the property that is subject to U.S. income tax is to be determined after taking into account all exclusions and exemptions, whether derived from a statute, a treaty, or otherwise, but total gross income from the use of the property is to be determined without regard to any such exclusions or exemptions.

Income taxed to a United States shareholder under section 951 for his taxable year in which or with which such taxable year of the foreign lessee ends will be treated as being subject to United States income tax for such taxable year.

3. Tax-Exempt Use Property

Personal property

For purposes of the depreciation and investment credit provisions of the bill, property which is not 15-year real property will be tax-exempt use property if it is owned by, leased to, or otherwise used by a tax-exempt entity.

Real property

In general

For purposes of the depreciation and investment credit provisions of the bill, 15-year real property will be treated as tax-exempt use property if it is owned by a tax-exempt entity, or to the extent it is used by a tax-exempt entity or entities if at least one of the following circumstances exists:

(1) All or a part of the property was financed with the proceeds of obligations the interest on which is exempt from tax under section 103 and the tax-exempt entity (or a related party) participated in such financing;

(2) The use is pursuant to a lease containing or accompanying (i) a fixed or determinable price purchase option exercisable by the tax-exempt entity (or a related party), (ii) a fixed or determinable price sale option pursuant to which the lessor can require the tax-exempt entity (or a related party) to purchase the property, or (iii) the equivalent of either such option;

(3) The use occurs after a sale, lease, or other disposition or transfer of the property from the tax-exempt entity (or a related party); or

(4) The use is pursuant to a lease with a term exceeding 20 years.

However, in no event will any portion of any 15-year real property be treated as tax-exempt use property unless more than 50 percent (35 percent in the case of use of a type or types described above by one tax-exempt entity and related tax-exempt entities) of the property is used by tax-exempt entities in a use of a type or types described above. For purposes of this rule, each building will be treated as a separate property unless two or more buildings are part of one project. In the latter case, the entire project will be treated as one property. Furthermore, uses of the types described above by unrelated tax-exempt entities will be aggregated in determining whether property is tax-exempt use property under the 50-percent threshold, and uses by unrelated tax-exempt entities will be aggregated in determining the extent to which property is tax-exempt use property once the 35-percent or 50-percent threshold has been met. Use by one tax-exempt entity related to another tax-exempt entity will be treated as use by the latter as well as the former. Finally, the extent to which property is tax-exempt use property will be measured by those factors producing the greatest amount of tax-exempt use. For example, assume that a tax-exempt entity sells a building, leasing 50 percent of it back for 25 years and leasing the other 50 percent back for 10 years. Because the entire building was sold and leased back, the entire building is tax-exempt use property even though only one-half of it was leased to the tax-exempt entity for a term exceeding 20 years.

The committee intends that a tax-exempt entity or entities will be treated as using that percent of a building equal to that percent of the net rentable floor space in the building it or they are leasing. Net rentable floor space is not to include common areas.

To illustrate the application of the rules for determining whether and to what extent 15-year real property is tax-exempt use property, assume in the examples that follow that a tax-exempt entity

participates in industrial development bond financing for the acquisition of a new building by a taxpayer. The tax-exempt entity leases 80 percent of the building for 5 years. Eighty percent of the building is tax-exempt use property under the bill. If the tax-exempt entity leased only 35 percent of the building for 25 years, no portion of the building would be tax-exempt use property. If the tax-exempt entity leased only 35 percent of the building for 5 years and an unrelated tax-exempt entity leased 10 percent of the building for 20 years, none of the building would be tax-exempt use property. If the tax-exempt entity leased only 35 percent of the building for 5 years and an unrelated tax-exempt entity leased 10 percent of the building for 25 years, 45 percent of the building would be tax-exempt use property.

If no tax-exempt financing had been used and if each of two unrelated tax-exempt entities leased 20 percent of a building for 25 years, none of the building would be tax-exempt use property. However, if each lease was for 30 percent of the building, 60 percent of the building would be tax-exempt use property.

Participation in tax-exempt financing

Whether a tax-exempt entity (or a related party) will be treated as having participated in financing the acquisition of all or a part of the property through tax-exempt obligations depends on all the circumstances. However, a tax-exempt entity will be treated as having participated if it (or a related tax-exempt entity) issues the obligations and it is reasonable to expect at the time of issuance that the tax-exempt entity will be a user of all or a portion of the property. A tax-exempt entity will also be treated as having participated in the financing if, prior to the financing, it commits to lease space in the building. For example, an organization described in section 501(c)(3) will be treated as having participated in a bond financing if, prior to the issuance of the bonds, it commits to enter into a lease of all or part of the property after it has been acquired by the taxpayer. If a tax-exempt entity finances the acquisition or construction of a building with tax-exempt obligations, sells the new building to the taxpayer before using it, and then leases all or a part of it, the tax-exempt entity will be treated as having participated in the financing.

Purchase or sale options

A fixed or determinable price purchase or sale option exists if the tax-exempt entity (or a related party), directly or indirectly, has a legally enforceable option to buy the property involved from the lessor, or the lessor has a legally enforceable right to "put" the property to the tax-exempt entity (or a related party), at some date at either a pre-established price or at a price that is determinable pursuant to a formula. An option or put at fair market value at the time of exercise will not be treated as a fixed or determinable price option or put. Nor will an option or put be so treated if the selling price is determinable pursuant to a formula which the parties, when agreeing to it, reasonably expected would produce a number approximately equal to fair market value at the time of exercise. An option to purchase in 15 years for an amount equal to 50 percent of original cost will be an option at a fixed or determin-

able price. However, an option to purchase at a price derived by a formula which incorporates rents then paid by taxable entities for the use of the same or similar property and then prevailing interest rates will not be an option at a fixed or determinable price, so long as the parties, when they agreed to the formula, reasonably expected it to produce a number approximately equal to fair market value at the time of exercise.

Furthermore, any provision which has the effect of passing on to the lessee or a related party the risk that the property's residual value will decrease will be treated as the equivalent of a fixed or determinable price put. For example, assume that a tax-exempt entity leases land to a taxable entity for 20 years. The taxable entity constructs a building, which has an economic useful life of 50 years, on the land and leases it to the tax-exempt entity for the balance of the term of the ground lease. Because the tax-exempt entity has dominion over the building for its entire economic useful life, the tax-exempt entity may be treated as its tax owner under present law. However, if the tax-exempt entity is not treated as the owner, the property would be tax-exempt use property in any event because the tax-exempt entity has the equivalent of a fixed price purchase or sale option. Similarly, assume that a lease provides that if the lessee cancels or fails to renew the lease or if the property involved is destroyed, the lessee will pay or cause to be paid to the lessor the difference between the amount necessary to preserve the lessor's net economic return and the fair market value of the property. The lease is treated as containing the equivalent of a determinable price sale option.

Neither an option nor a put needs to be contained in the lease. Either may be (or be included in) a separate agreement. An option to buy or put stock in a corporation (or equity interests in any other entity) which owns the property may be treated as an option to buy or put the property.

Uses after transfers

The use by a tax-exempt entity after a disposition or other transfer of the property by the entity (or a related party) includes all forms of transactions in which a tax-exempt entity (or a related party), directly or indirectly, sells, leases, disposes of, or otherwise transfers property theretofore owned by it and subsequently uses it. For example, if a tax-exempt entity contributes a building to a partnership and leases back a portion of the building, the transaction will be treated as a sale-leaseback for purposes of the bill. As a further example, if property is owned by a corporation that is owned by a tax-exempt entity, a sale or other disposition of the stock of that corporation will be treated as a sale or other disposition of the property. Finally, property owned by a tax-exempt entity (or a related party) which is subsequently leased to the tax-exempt entity pursuant to one overall arrangement will be tax-exempt use property regardless of from whom the lessor obtained the property. For example, assume a tax-exempt entity sells a building to a taxable entity. The taxable entity sells or contributes the building to a partnership which, pursuant to one overall plan, leases it to the tax-exempt entity. The building is tax-exempt use property.

If a tax-exempt entity (or a related party) disposes of its ownership interest in a property and then leases it back within three months after it was placed in service by the tax-exempt entity (or a related party), the tax-exempt entity will not be treated as having used the property after having transferred it.

Improvements

The bill provides that improvements to property (other than land) will not be treated as separate property, but only for purposes of determining whether there is tax-exempt use of property not owned by a tax-exempt entity under the tax-exempt financing rule or the use after transfer rule. For example, if a governmental unit issues tax-exempt obligations, the proceeds of such issue are used by a taxpayer to acquire a building shell from a third party, and the taxpayer improves the building shell using other funds and leases the improved building to the governmental unit, the governmental unit will be treated as having participated in the tax-exempt financing of the entire property. Similarly, if a tax-exempt entity sells a building shell to a taxpayer and the taxpayer rehabilitates the building shell and leases the rehabilitated building back to the tax-exempt entity, the tax-exempt entity will be treated as using one property after a sale-leaseback.

On the other hand, if unimproved land is disposed of by a tax-exempt entity, a building is constructed on the land by the new owner, and the improved land is leased to the tax-exempt entity, the building will not be treated as having been the subject of a sale-leaseback.

Tax-exempt use property does not include improvements constructed by a taxable entity on underlying land or other property leased from a tax-exempt entity merely because the tax-exempt entity is the owner of the land or other property. For example, assume that a tax-exempt university leases land to a taxable entity for 45 years. The taxable entity constructs a building, which has an economic useful life of 40 years, on the land and leases it to a third-party taxpayer (or the university) for 20 years. The building is not tax-exempt use property. Similarly, assume that a municipality leases a certified historic structure to a taxable entity for 20 years. The taxable entity rehabilitates the structure in one year, using industrial revenue bonds, in a rehabilitation qualifying under section 48(g), converting it into a shopping mall. The rehabilitated mall is leased, piece-by-piece, to a variety of taxable merchants. No leasehold improvement is tax-exempt use property. However, the municipality is the tax owner of the building shell.

Other rules

A determination that there is a tax-exempt use of property does not require that the ultimate user of the property be a tax-exempt entity. A disqualified use at any point in a chain of use subjects the property to the bill. A similar rule applies with respect to the nontaxable use restriction of present law. For example, assume that a corporation constructs a new convention center and leases it to a city under an arrangement in which the city has a fixed price option to buy after 20 years. The city subleases or licenses the

property to a variety of taxable entities that use it. The entire structure is tax-exempt use property.

Nor can a tax-exempt entity avoid the provisions of the bill merely by being a sublessee. Thus, if corporation A leases 15-year real property to corporation B under a lease with a fixed price option and corporation B subleases the property to a tax-exempt entity, assigning its fixed price option to the tax-exempt entity, the property will be tax-exempt use property.

Whether the tax-exempt entity is the tax owner of the property will be determined under present law. For example, a tax-exempt entity may hold legal title to property, used by a taxable entity, as a security device in connection with an industrial revenue bond. If the tax-exempt entity is not the tax owner of the property, the mere fact that it has legal title will not cause the property to be treated as tax-exempt use property. *See* Rev. Rul. 68-590, 1968-2 C.B. 66.

Tax-exempt use property does not include any property or portion thereof predominantly used by a tax-exempt entity in an unrelated trade or business the income of which is subject to tax under section 511.

4. Depreciation

General recovery period and method

In the case of tax-exempt use property, accelerated cost recovery deductions and any other deductions for depreciation or amortization are to be computed by using the straight-line method and disregarding salvage value. The recovery period for tax-exempt use property in the 15-year real property class is 40 years or 125 percent of the term of the lease, whichever is greater. The recovery period for all other tax-exempt use property is the mid-point life of the property as of January 1, 1981, under the ADR system, or 125 percent of the term of the lease, whichever is greater. Personal property that has no ADR life will be treated as having a mid-point life of 12 years.

However, the depreciation provisions of the bill do not apply to tax-exempt use property used by a foreign person or entity if such property is placed in service before January 1, 1984, and is used by such foreign person or entity pursuant to a lease entered into before January 1, 1984. Nor do the depreciation provisions of the bill apply to any such property which is subleased by such foreign person or entity to another foreign person or entity after 1984. In the case of tax-exempt use property placed in service during 1984 and used by a foreign person or entity pursuant to a lease entered into during 1984, depreciation will be allowed (1) on the 175 declining balance method, switching to the straight-line method, over the recovery period provided by the bill or (2) as under present law, whichever is the less rapid. All other tax-exempt use property used by a foreign person or entity will be allowed depreciation (1) on the 150-percent declining balance method, switching to the straight-line method, over the property's ADR mid-point life or (2) as under present law, whichever is the less rapid.

Property treated as leased under the bill's provisions for distinguishing service contracts and other arrangements from leases (see

below) will be treated as leased for purposes of all Federal income tax provisions, including the depreciation provisions of the bill.

Short-lived property

The depreciation provisions of the bill do not apply to short-lived property used by a tax-exempt entity pursuant to a lease with a term equal to 75 percent or less of the property's ADR mid-point life (5 years in the case of property with an ADR mid-point life of 6 years).

As with other property, whether short-lived property purportedly leased to a tax-exempt entity is to be treated as owned for tax purposes by the tax-exempt entity will be determined under present law. For example, if short-lived property with an economic useful life of 3 years is purportedly leased for 3 years, the nominal lessee may be treated as the tax owner of the equipment.

For purposes of the bill, short-lived property consists only of property with an ADR mid-point life of 6 years or less. However, high technology medical equipment will be deemed to have an ADR mid-point life of 6 years. High technology medical equipment includes only electronic, electromechnical, or computer-based high technology equipment used in the screening, monitoring, observation, diagnosis, or treatment of human patients in a laboratory, medical, or hospital environment. High technology medical equipment can include C.A.T. scanners, nuclear magnetic resonance equipment, clinical chemistry analyzers, drug monitors, diagnostic ultrasound scanners, nuclear cameras, radiographic and fluoroscopic systems, Holter monitors, and bedside monitors. Incidental use of any such equipment for other purposes, e.g., research, will not prevent it from qualifying as high technology medical equipment. High technology medical equipment consists only of equipment which, because of a high technology content, can reasonably be expected to become obsolete before the expiration of its physical useful life.

High technology medical equipment will not include any property determined under final regulations to have an ADR mid-point life of more than 6 years. However, no such regulations are to apply to property placed in service prior to the date such final regulations are published in the Federal Register.

Operating rules

If a taxpayer elects under ACRS to recover the cost of property over an optional recovery period that exceeds the recovery period prescribed by the bill, then the cost of the property is to be recovered over the longer period. Property which would be 15-year real property if it were recovery property is treated as 15-year real property for purposes of the bill. For 15-year real property, first-year deductions are to be determined on the basis of the number of months in the year in which the property is in service. For other property, the half-year convention used under present law applies. For example, if the recovery period under the bill is 10 years, the cost recovery percentage will be 5 percent for the taxable year the property is placed in service by the taxpayer, 10 percent for each of the next 9 taxable years, and 5 percent for the eleventh taxable year.

Section 168(f)(12) of present law (relating to depreciation of certain property financed with industrial development bonds) is not to apply to tax-exempt use property.

The committee intends that regulations be promulgated under section 168(f)(13) (relating to changes in use of depreciable property) of present law to apply to property the tax ownership of which has not changed which either becomes or ceases to be tax-exempt use property some time after having been placed in service by the taxpayer.

5. Investment Tax Credit

As under present law, the investment credit (including the investment credit for energy property) generally will be denied for property (including short-lived property) leased to or otherwise used by tax-exempt entities. However, the investment credit provisions of the bill do not apply to tax-exempt use property used by a foreign person or entity if such property is placed in service before January 1, 1984, and is used by such foreign person or entity pursuant to a lease entered into before January 1, 1984. Nor do the investment credit provisions of the bill apply to any such property which is subleased by such foreign person or entity to another foreign person or entity after 1984. In the case of tax-exempt use property placed in service during 1984, and used by a foreign person or entity pursuant to a lease entered into during 1984, the investment credit allowed will be one-half of the investment credit available under present law.

The bill expands the category of tax-exempt entities subject to the nontaxable use restriction and provides statutory guidelines for distinguishing a service contract or other arrangement from a lease (see below). Property which becomes tax-exempt use property some time after having been placed in service will cease to be section 38 property at the time it becomes tax-exempt use property with the result that all or part of the investment credit may be recaptured. The present-law exception to the nontaxable use restriction for short-term or casual leases is replaced by an objective short-term lease exception.

Expenditures attributable to the rehabilitation of any portion of a building that is (or is reasonably expected to be) tax-exempt use property will not qualify for the rehabilitation credit. However, the excluded expenditures will be taken into account under section 48(g)(1)(C) in determining whether there has been a substantial rehabilitation of the building. If all or a portion of a substantially rehabilitated building becomes tax-exempt use property for the first time within 5 years, rehabilitation credits will be recaptured at that time as if that portion of the building which becomes tax-exempt use property had then been disposed of.

For example, assume that a taxpayer acquires a building for $25,000 and spends $30,000 rehabilitating it. Two-thirds of the rehabilitated building is then leased to a tax-exempt entity under circumstances which make the two-thirds tax-exempt use property. No rehabilitation credit will be allowed on the $20,000 in rehabilitation expenditures attributable to that part of the building which is tax-exempt use property. However, a rehabilitation credit will be

allowed on the other $10,000 in rehabilitation expenditures. If the other one-third of the building becomes tax-exempt use property within 5 years, rehabilitation credits on the $10,000 will be recaptured.

Other rule

Section 46(e)(2)(A) of present law in effect limits thrift institutions to 50 percent of the investment credit that would otherwise be available with respect to property they own. Under the bill, a lessor of property to a thrift institution will be unable to claim investment credit in excess of that which the thrift institution could have claimed had it acquired the property as owner.

6. Property Used Under Certain Service Contracts

The committee bill provides that a purported service contract or other arrangement with a tax-exempt entity or other person will not be treated as a service contract if it is more properly characterized as a lease. This provision of the bill applies to contracts under which property is used to provide services to or for the benefit of a tax-exempt entity or another person. The bill creates no inferences regarding the treatment of service contracts under present law. Nor does the bill affect the present-law rules for determining the treatment of management contracts under which a tax-exempt entity or other person performs services with respect to property owned by a taxpayer.

The service contract provision applies for all purposes of the income tax provisions of the Internal Revenue Code, including the depreciation provisions of the bill and the nontaxable use restriction on the investment credit (as modified by the bill). This provision applies to service contracts involving personal property or real property, regardless of whether the so-called service provider is the tax owner or the lessee of the property.

Factors to be considered

In determining whether a transaction structured as a service contract is more properly treated as a lease, the committee bill requires that all relevant factors be taken into account, including, but not limited to, whether (1) the tax-exempt entity or other purported service recipient is in physical possession of the property, (2) such recipient controls the property, (3) such recipient has a significant possessory or economic interest in the property, (4) the service provider bears any risk of substantially diminished receipts or substantially increased expenditures if there is nonperformance under the contract, (5) the service provider uses the property concurrently to provide services to other entities unrelated to the recipient, and (6) the total contract price substantially exceeds the rental value of the property for the contract period.

Physical possession

Physical possession of property is indicative of a lease. Under the bill, property that is located on the premises of a service recipient, or located off the premises but operated by employees of such recipient, is viewed as in the physical possession of the recipient.

However, property is not in the physical possession of the recipient merely because the property is located on land leased to the service provider by the recipient.

Control of the property

The fact that the service recipient controls the property is indicative of a lease. Under the bill, a service recipient is viewed as controlling the property to the extent such recipient dictates or has a contractual right to dictate the manner in which the property is operated, maintained, or improved. Control is not established merely by reason of contractual provisions designed to enable the recipient to monitor or ensure the service provider's compliance with performance, safety, pollution control, or other general standards.

Possessory or economic interest

A contract that conveys a significant possessory or economic interest to a service recipient resembles a lease. Under the bill, the existence of a possessory or economic interest in property is established by facts that show (1) the property's use is likely to be dedicated to the service recipient for a substantial portion of the useful life of the property, (2) the recipient shares the risk that the property will decline in value, (3) the recipient shares in any appreciation in the value of the property, (4) the recipient shares in savings in the property's operating costs, or (5) the recipient bears the risk of damage to or loss of the property.

Substantial risk of nonperformance

Under a service contract arrangement, the service provider bears the risk of substantially diminished receipts or substantially increased expenditures if there is nonperformance under the contract. Under the bill, facts that establish that the service provider does not bear any significant risk of nonperformance are indicative of a lease.

Concurrent use of property

The concurrent use of the property to provide significant services to persons unrelated to the service recipient is indicative of a service contract.

Rental value of property relative to total contract price

The fact that the total contract price (including expenses to be reimbursed by the service recipient) substantially exceeds the rental value of the property for the contract period is indicative of a service contract. If the total contract price reflects substantial costs that are attributable to items other than the use of the property under the contract, then the contract more closely resembles a service contract. Conversely, the fact that the total contract price is based principally on recovery of the cost of the property is indicative of a lease. A contract that states charges for services separately from charges for use of property is indicative of a lease with a separate service contract.

Other rules

A contract will be treated as a lease rather than a service contract if the contract more nearly resembles a lease. Although each of the factors in the bill must be considered, a particular factor or factors may be insignificant in the context of any given case. Similarly, because the test for determining whether a service contract should be treated as a lease is inherently factual, the presence or absence of any single factor may not be dispositive in every case. For example, even if a tax-exempt entity or other service recipient does not have physical possession of property, the arrangement could still be treated as a lease after taking all other relevant factors into account.

Examples

The following examples illustrate the application of the service contract provision of the committee bill. In each of these examples, T is a taxpayer and E is a tax-exempt entity.

Example (1)

E, an agency of the Federal government, desires to obtain the use of a built-to-purpose vessel. A contractor arranges for the construction of the vessel and for the sale of the vessel to T. The contractor then leases the vessel from T, the shipowner, under a long-term bareboat charter. E and the contractor enter into a time charter with respect to the vessel. The time charter provides for the transportation of equipment, cargo, and personnel. Under the time charter, E has the right to designate the port of call and the cargo to be carried. The master, officers, and crew of the vessel are hired by the contractor, subject to E's approval. All officers of the vessel must qualify for a government "confidential" security clearance. In addition, the master, chief officer, and radio officer must qualify for a government "secret" security clearance. E reserves the right to station 28 permanent government personnel aboard the vessel and to assign up to 100 additional military personnel to the vessel. However, the master of the vessel is under the direction of the contractor as regards navigation and care of the cargo. E also has the right to cause alterations to be made to the vessel. E must make separate payments for "Capital Hire" (computed by reference to the amount required to repay, with interest or a guaranteed return, the debt financing and equity investment of T) and "Operating Hire" (which covers the cost of operating the vessel and the contractor's profit). Payments of Operating Hire are suspended or reduced when the vessel is not fully available for service. However, E must continue to pay Capital Hire during such period.

The time charter has an initial term of 5 years. E has the option to extend the basic term for one to four successive renewal periods, on similar terms, for a total of 25 years. The useful life of the vessel is in excess of 30 years. E can terminate the time charter for convenience at any time during the renewal periods. Upon a termination for convenience or if E fails to exercise a renewal option, E is required to pay any difference between the proceeds of the sale of the vessel and the "Termination Value" set forth in the time charter. The "Termination Value" is an amount approximating T's

unrecovered equity, remaining debt service, and tax liability generated by the vessel's sale. E has the option to purchase the vessel at any time after the end of the basic 5-year term for the greater of fair market value or Termination Value at the time of purchase. If E purchases the vessel, E can require that the contractor continue to operate the vessel under the same terms as set forth in the time charter. If the vessel is damaged, destroyed, or otherwise lost due to causes beyond the contractor's control, E must pay any difference between Termination Value and any insurance proceeds. Thus, E also bears the risk of damage to or loss of the vessel.

E may be considered the owner of the vessel under the general principles for determining ownership for Federal income tax purposes. If, however, T were considered the owner, under the bill E would be treated as having a leasehold interest in the property (and the vessel would be tax-exempt use property). In the latter case, the following facts would serve as the basis for the conclusion that E would be treated as having a leasehold interest: (a) E has some control over the vessel because E can direct that alterations be made, (b) E has a significant possessory interest because the time charter contemplates that the vessel's use will be dedicated to E for a substantial portion of its useful life, the requirement that Termination Value be paid shifts the risk that the vessel will decline in value to E, and E bears the risk of damage to or loss of the vessel, (c) T does not bear a substantial risk of nonperformance within the meaning of the bill because payments of Capital Hire continue even if the vessel is unavailable for service, (d) regarding the rental value of the property relative to the total contract price, the test for a service contract is not satisfied since the Capital Hire represents payments for the cost of the vessel and the Operating Hire represents separate payments for services, and (e) all other relevant facts and circumstances, including the facts that the vessel was built-to-purpose and the terms of E's purchase option. The facts that the contractor (and not E) has physical possession of the vessel and that there is no concurrent use of the vessel to provide services to other persons are insignificant in the context of this case.

Example (2)

The facts are the same as in example (1) except that (a) E has no right to make alterations to the vessel, (b) E's obligation to pay charter hire is set at a rate per deadweight ton and is subject to the condition that the vessel be in full working order, (c) the time charter has an initial term of 5 years, with an option to renew for one to five one-year periods, for a total of 10 years, (d) T bears the risk of damage to or loss of the vessel, and (e) E has no option to purchase the vessel. In addition, E is not required to pay Termination Value (or any other penalty) if it fails to exercise a renewal option.

On these facts, the time charter will be respected as a service contract under the bill (and the vessel will not be tax-exempt use property). The following facts provide the basis for that conclusion: (a) E has no control over the vessel, (b) E has no possessory or economic interest in the vessel, (c) the contractor bears a substantial risk of nonperformance, since the contractor will receive no rev-

enues if the vessel is unavailable for service, and (d) the facts do not indicate that any portion of the charter hire is based on the cost of the vessel.

Example (3)

E, a municipal housing authority, owns Section-8-assisted low-income housing projects. E sells the property to T, a partnership of taxable persons. In order to ensure that the purposes of the Section-8 housing program are fulfilled, T retains E to manage the property under a long-term management contract. Under the management contract, E performs many of the same managerial and administrative functions that it performed before the sale. However, T exercises a degree of control over E's activities, by virtue of provisions in the management contract that require E to keep adequate records of its operations, to use its best efforts to lease the housing units, and to pay net earnings to T within a reasonable time period. For these services, E is compensated by a fee determined on an arm's-length basis. T bears the risk that the property will decline in value and that the property will be damaged or lost. E does not have an option to repurchase the property.

The mere fact that E continues to control the maintenance and operation of the property under a management contract does not provide a basis for treating the contract as a lease under the service contract provision of the bill. However, the bill leaves open the possibility that an arrangement structured as a management contract could be treated as a lease (under which the manager provides services to third parties for its own benefit) under present law rules. *See McNabb* v. *Commissioner*, 81-1 USTC 9143 (W.D. Wash. 1980) (where an arrangement structured as a management contract was characterized as a lease because the taxpayer did not adequately control the venture and did not bear the risk of loss); *Meagher* v. *Commissioner*, 36 T.C.M. 1091 (1977) (where the court held that an agreement was a management contract and not a lease, applying the same tests discussed in the *McNabb* case).

Example (4)

E, a municipal agency, acquires an industrial park and then leases the facility to T, a taxable person, for a term in excess of 15 years. T substantially rehabilitates the building, and then subleases the improved property to other taxable persons. T retains E to manage the property under a management contract.

T owns the improved portion of the building. The mere fact that E performs services with respect to the entire property under a management contract does not provide a basis for treating the improvements as tax-exempt use property under the service contract provision of the bill. Rather, the status of the management contract, as it relates to the leasehold improvements, is determined under present-law rules.

Example (5)

E, a municipality, and T, a private company, enter into a long-term agreement under which E will be the primary but not the only customer of a local district heating system (the System) that will be constructed, owned, operated, and maintained by T. The

agreement between E and T does not qualify for the exception for qualified energy contracts (see below).. A local district heating system consists of a pipeline or network which includes or is connected to a central heating source (such as a cogeneration facility or a solid waste resource recovery facility) that furnishes energy for heating through hot water or steam to two or more users for residential, commercial, or industrial heating or processing of steam. The System requires periodic maintenance and repair. The agreement between E and T provides for the distribution of BTUs to buildings owned by E. 40 to 75 percent of T's investment in the System will be allocable to the cost of pipeline, and the balance will be allocable to the cost of building or retrofitting a heating source. Approximately 97 percent of the pipeline included in the System is located off of E's premises. The only part of the System located on E's premises are pipes (for delivering the energy), meters (to measure E's usage), and heat exchangers. The in-building investment (attributable to pipes, meters, and heat-exchangers) may, in the case of some of the buildings owned by E, be made by E. In many cases, the only in-building investment made by T will be the cost of a meter. E will make monthly payments to T, determined by the amount of energy E consumes. T will also use much of the System to distribute BTUs to buildings owned by taxable persons in T's service area, under similar contracts.

On these facts, the agreement between E and T will not be treated as a lease. The following facts provide the basis for that conclusion: (a) E has physical possession of, at most, only a nominal part of the System, (b) E does not control the System, (c) T bears a substantial risk of nonperformance in that T will derive revenue from E based solely on the amount of energy E consumes, (d) T concurrently uses the System to distribute BTUs to others, and (e) T will be required to perform significant services. The fact that E has an economic or possessory interest in the property is, under the circumstances, outweighed by the other factors.

Exception for qualified solid waste disposal facilities

The bill provides an exception to the service contract provisions for qualified solid waste disposal facilities. The exception for qualified solid waste disposal facilities creates no inferences regarding the treatment of property subject to the general service contract provision.

The term "qualified solid waste disposal facility" is defined as any facility that provides solid waste disposal services for residents of part or all of one or more governmental units, if substantially all of the solid waste processed at such facility is collected from the general public. For purposes of this rule, the general public includes commercial businesses, but only if the waste collected from such businesses is collected from them in their capacities as members of the general public (and not as members of a limited group such as a group that generates waste not processable by normal waste facilities serving the public).

Exception not to apply in certain cases

The exception for qualified solid waste disposal facilities does not apply, and the facilities will be treated as leased, if the tax-exempt

entity or other purported service recipient (or a related entity) (1) operates the facility, (2) bears any significant financial burden if there is nonperformance under the contract (other than for reasons beyond the control of the service provider), (3) receives any significant financial benefit if operating costs of the facility are reduced as the result of technological changes or other efficiencies introduced by the service provider, or (4) has an option to purchase, or may be required to purchase, all or a part of the facility at a fixed and determinable price (other than at fair market value). An option or put that would not be treated as an option or a put at a fixed or determinable price under the rules regarding tax-exempt use of 15-year real property will not be treated as an option or a put at a fixed or determinable price for this purpose.

In general, for purposes of determining whether a facility is eligible for the exception to the general service contract provision, a tax-exempt entity's or other recipient's right to inspect the facility, exercise its sovereign power (in the case of a governmental unit), and to act in the event of a breach of contract by the service provider are not to be taken into account. Similarly, the allocation of the benefits and burdens of change in law are not taken into account.

For purposes of determining whether a recipient bears a significant financial burden, the following factors are to be disregarded: (1) temporary shut-downs of the facility for repairs, maintenance, or capital improvements and (2) financial burdens resulting from the bankruptcy or other financial difficulty of the service provider. The determination of whether the recipient receives a significant financial benefit as the result of certain reductions in operating costs is to be made without regard to (1) adjustments or payments based on the quantity of solid waste processed at the facility or (2) financial benefits generated by the production of energy or other recoveries.

Example (6)

E, a municipality, and T, a private company, enter into a solid waste disposal agreement under which T will construct, own, and operate a solid waste resource recovery facility (the Facility) on land leased from E. The Facility will process solid waste (of the type that is currently collected and disposed of as a part of normal municipal collections), generate steam, convert the steam to electricity, and recover ferrous metals from residual ash. T will invest 25 percent of the construction costs, and the balance will be financed with the proceeds of an issue of tax-exempt industrial development bonds to be issued by E. T will construct the project over a 3-year period and operate it for 20 years. E has the option to purchase the Facility at the end of the 20-year term, at the then fair market value of the Facility. Pursuant to a related energy purchase agreement, U, a utility, will be required to purchase a minimum amount of steam during each year of the same 20-year period. Absent default by T, E will pay an annual fee based on the greater of 400,000 tons of solid waste, regardless of whether such amount is actually delivered, or the number of tons of solid waste actually delivered. The fee is subject to a downward adjustment to reflect increases in T's energy revenues. T bears the primary risks

of cost overruns and construction delays. E is entitled to receive 80 percent of all interest-cost savings resulting from a financing or refinancing of the tax-exempt bonds at a reduced interest rate.

E can terminate the agreement on performance grounds. In that event, E might obtain possession of the Facility until a new operator is found. In addition, E's employees will be present at the Facility to perform tasks such as delivering the solid waste, carrying away the residue or ash, or monitoring T's compliance with contractual performance standards.

If the Facility is shut down, E remains obligated to make payments equal to 10 percent of the minimum annual fee. Also in the case of a shut-down, E will incur costs for trucking and alternate disposal, which costs may approximate 150 percent of the fee that would otherwise be payable to T. If a shut-down is caused by the delivery of hazardous waste or other unsuitable materials, or by the imposition of Federal regulations prohibiting operation of the Facility, E will remain obligated to pay the minimum annual fee.

The Facility qualifies for the exception to the service contract provision because (a) the solid waste disposed of is collected from the general public, (b) E is not viewed as operating the property, notwithstanding the ability of E's employees to ensure that T complies with general performance standards or the tasks performed by such employees at the Facility, (c) E does not bear any significant burden if there is nonperformance under the contract (other than for reasons beyond T's control), (d) E will not benefit from a reduction in operating costs attributable to efficiencies introduced by T, and (e) E's purchase option is at fair market value.

Example (7)

E, a municipality, enters into a long-term solid waste disposal service contract with T, the operator. The contract obligates T to design, construct, and operate a 2,000 ton per day solid waste disposal resource recovery facility for an annual charge (computed as the cost of debt service on bonds issued to finance the facility, plus a fixed annual operation fee escalated for inflation, minus T's 90% share of the revenues derived from the sale of electricity produced by the facility). T has the option to purchase the facility at the expiration of the contract term at the then fair market value. T concurrently enters into a facility loan agreement with P, a public authority, providing for a loan to T of the proceeds of tax-exempt industrial development bonds issued by P to finance a portion of the cost of the facility and the construction of the facility by T to performance standards. The facility loan agreement provides that if T fails to construct a solid waste disposal facility capable of processing at least 1,500 tons per day of solid waste within 5 years, T must, as liquidated damages, pay or provide for the payment of P's bonds, and thereupon will have no further obligation. Neither the service contract nor the facility loan agreement entitles E to any damages in the event of T's nonperformance. Should T fail to perform its obligation to build a plant with a waste throughput capacity of at least 1,500 tons per day, E will suffer costs and expenses associated with having planned, developed and negotiated for service from an inoperable plant, costs of developing a replacement disposal arrangement, and costs of transporting and landfilling waste

that was expected to be disposed of at the original facility. Although the financial burdens to E from T's nonperformance may be significant, they arise from the continuing duty of E to dispose of waste and are not directly caused by T's nonperformance. The facility therefore does not constitute property leased to E.

Exception for certain contracts

The bill also provides exceptions to the service contract provision for property used under a contract involving energy or clean water facilities. These exceptions apply to contracts between a tax-exempt entity or other service recipient and a service provider under which (1) electrical or thermal energy is produced at a cogeneration or alternative energy facility and sold to the recipient, (2) energy conservation or energy management services are provided to the service recipient, or (3) the service provider operates a water treatment works facility as defined for purposes of section 212(2) of the Federal Water Pollution Control Act.

A cogeneration facility is a facility that uses the same source of energy for the sequential generation of electrical or mechanical power in combination with steam, heat, or other forms of useful energy. The term "alternative energy facility" is defined as a facility for producing electrical or thermal energy the primary energy source for which is not oil, natural gas, coal, or nuclear power.

In general, a contract for energy conservation or energy management services involves one or more of the following services: (a) an energy audit to identify opportunities to save energy in a building, (b) engineering design and specifications for energy management, (c) retrofitting of existing equipment or the installation of a renewable energy system, (d) training of personnel, (e) complete maintenance and operation of any equipment installed, and (f) continued monitoring by the service provider's employees who have access to the equipment installed on the premises of the service recipient, including the preparation of periodic reports to the recipient. The service provider's compensation may be based on a percentage of the savings resulting from the service provider's services. Alternatively, the contract may provide for a guaranteed saving to the recipient. The term of those types of contracts usually approximate ten years, at the end of which the recipient may have the option to purchase the equipment installed on its premises at fair market value. During the term of the contract, the service provider generally has the right to replace or alter equipment installed on the recipient's premises in order to further reduce energy consumption.

Exception not to apply in certain cases

The exception for contracts involving energy or clean water facilities does not apply, and any property involved will be treated as leased, if the tax-exempt entity or other purported service recipient (or a related entity) (1) operates the property, (2) bears any significant financial burden if there is nonperformance under the contract (other than for reasons beyond the control of the service provider), (3) receives any significant financial benefit if operating costs of property of the service provider are reduced as the result of technological changes or other efficiencies introduced by the service provider, or (4) has an option to purchase, or may be required to

purchase, all or a part of the property at a fixed and determinable price (other than at fair market value). In applying those rules, the fixed or determinable price rules applicable under the exception for qualified solid waste disposal facilities are to be used.

Example (8)

T, a private company, and E, a Federal governmental agency, enter into a contract under which T will construct and operate a solar energy system (the System). The System will be owned by a group of private investors. The System will be constructed on the roof of a building owned by E. All of the hot water and steam produced by the System will be sold to E under a long-term contract. E must pay a significant penalty if it defaults on the contract. However, T will receive no revenues under the contract unless the System produces energy. T is solely responsible for the operation and maintenance of the Facility. However, because the Facility is substantially maintenance free, the total contract price exceeds the rental value of the Facility by only 5 to 10 percent. Upon expiration of the contract, E has the option to purchase the system at fair market value.

The agreement between E and T qualifies for the exception for contracts involving energy facilities because (a) the contract provides for the sale of energy to E and the energy is produced by an alternative energy facility, (b) E does not operate the system, (c) E does not bear any significant financial burden if there is nonperformance under the contract, (d) E does not receive any financial benefit if T's operating costs are reduced, and (e) E's purchase option is at fair market value.

Treatment of partnerships and other pass-through entities and other arrangements

The committee is concerned that taxpayers and tax-exempt entities may attempt to structure transactions to avoid the restrictions of the bill. Transactions of this character might include the use of partnerships or other pass-through entities. To deal with those transactions, the bill contains two anti-abuse provisions.

First, if a partnership has among its partners a tax-exempt entity and a person who is not a tax-exempt entity, each tax-exempt entity's proportionate share of each item of income, gain, loss, deduction, credit, and basis attributable to such property will be allocated to each such tax-exempt entity. The determination of a tax-exempt entity's proportionate share is made on the basis of such entity's interest in the partnership's taxable income or cash flow, whichever basis results in the larger proportionate share. Where the application of the previous sentence results in allocation of more than 100 percent of tax items, then allocation among tax-exempt entity partners will be made on a ratable basis. A tax-exempt entity's proportionate share in tax items attributable to property is based upon the largest interest in taxable income or cash flow allocated it under the partnership agreement. For example, if a partnership agreement provides that a tax-exempt entity is to have a 10-percent interest in taxable income and cash flow for the first 5 years of the life of the partnership and a 90-percent interest thereafter, the tax-exempt entity would be treated as having

a constant 90-percent interest. The bill provides for the application of similar rules to other pass-through entities (such as a trust).

The committee bill does not affect the present-law rule for determining the tax status of property that is co-owned by a tax-exempt entity under an arrangement that is not classified as a partnership for Federal tax purposes. Thus, a tax-exempt entity will continue to be viewed as owning a separate undivided interest in property held by a joint venture that is classified as a co-tenancy under Federal tax law. *See* Rev. Rul. 78-268, 1978-2 C.B. 10 (which addresses this issue in the context of applying the present-law nontaxable use restriction on the investment credit).

Second, the committee bill provides that an arrangement other than a service contract (including but not limited to a partnership or other pass-through entity) with a tax-exempt entity (or a related party) that purports not to be a lease is to be treated as a lease if such arrangement is more properly treated as a lease. In determining whether any given arrangement is more properly treated as a lease, all relevant factors are taken into account, including factors similar to those set forth in the general service contract provisions. This provision is applicable to any arrangement, other than a service contract, under which a tax-exempt entity directly or indirectly obtains the use or benefits of property.

Example (9)

E, a not-for-profit hospital, and T, a partnership composed of individuals who are active members of E's medical staff, enter into a joint venture to acquire and operate a computer axial tomography (or "C.A.T.") scanner. The C.A.T. scanner will be used solely to aid in the diagnosis of diseases of E's patients. Each joint venturer will contribute equal amounts of debt and cash towards the purchase price of the property, and will share equally in taxable income and cash flows. The C.A.T. scanner, which will be located on the premises of E, will be operated by members of T. The day-to-day business of the joint venture will be managed by a representative of each joint venturer. Under the joint venture agreement, T will be responsible for the billing of all technical charges and will receive two percent of gross charges for costs associated with preparing, mailing, and collecting charges. E will bill the joint venture and be reimbursed for occupancy costs (including utilities, housekeeping services, building depreciation, and interest) relating to the location of the C.A.T. scanner on its premises. The joint venturers will be separately responsible for interest, taxes, and insurance relating to participation in the joint venture. However, E is ultimately liable for the debt service obligations with respect to the entire property. The joint venture will terminate at the end of five years. The useful life of the C.A.T. scanner is approximately nine years. Within six months of termination, T can require that E purchase T's interest in the joint venture at fair market value, adjusted upward if fair market value is less than a price specified in the contract (which price is computed by reference to the amount required to repay T's equity investment with a guaranteed return, less the net profits received by T during the term of the joint venture).

25-551 O—82——6

E is viewed as owning a separate undivided interest in at least 50 percent of the C.A.T. scanner, regardless of whether the joint venture is classified as a partnership or as co-tenancy for Federal tax purposes. Thus, E's interest in the property is tax-exempt use property under the general provisions of the bill, since E does not use the property in an unrelated trade or business the income from which is subject to tax. E will be allocated its proportionate share of each item of income, gain, loss, deduction, credit, and basis attributable to the C.A.T. scanner.

The joint venture agreement is also subject to the provision of the bill relating to arrangements other than service contracts that purport not to be leases insofar as such agreement relates to T's interest in the property.

The property, by being used for E's patients, is being used for the benefit of E. Under the bill, taking into account factors similar to those enumerated in the general service contract provision, the arrangement is treated as conveying to E a leasehold interest in T's interest in the property. Thus, the entire property is tax-exempt use property. The following facts provide the basis for this conclusion: (a) although no payments are required to be made by E to T, T will be compensated through payments made by E's patients and by the terms of the put, (b) E has control of T's interest in the property because E has an equal voice in the operation and maintenance of the entire property, (c) E has a possessory interest in T's interest because the property will be used under the agreement for a substantial portion of the property's useful life and E bears the risk that the property will decline in value by virtue of the put held by T, (d) T does not have the right to use the property to provide services to anyone other than a patient of E, and (e) all other relevant facts, including the facts that the use of the property is integrally related to E's tax-exempt function, that E has guaranteed the repayment of the total acquisition indebtedness, and that the property will be operated only by E's employees. Given the totality of the facts and circumstances, the fact that T bears a risk of substantially diminished receipts is mitigated by E's obligation to fulfill T's debt service requirements and does not provide a basis for a contrary conclusion.

The C.A.T. scanner does not qualify for the special rule for short-lived property because the term of the agreement exceeds five years. Thus, the entire C.A.T. scanner is subject to reduced depreciation and is ineligible for the investment credit.

Scope of service contract provisions

As indicated above, the provisions of the bill describing factors to be used to distinguish service contracts and other arrangements from leases are to apply for all Federal income tax purposes, even if no tax-exempt entity is involved. For example, assume a taxpayer and a public utility enter into a purported service agreement pursuant to which the taxpayer is to provide electrical energy to the public utility for resale by the public utility. If the arrangement would be characterized as a lease of property to the public utility under the appropriate set of service contract criteria discussed above, the property would be treated as used by the public for utility purposes of, e.g., section 46(c)(3)(B) and section

167(l)(3)(A). Similarly, a so-called service contract will generate rents under section 543(a)(2) if, after application of the appropriate services contract criteria, the arrangement more nearly resembles a lease of property.

Regulations

The Secretary is to prescribe such regulations as may be necessary or appropriate to carry out the purposes of the bill rules relating to service contracts and other arrangements.

7. Short-Term Lease Exception

Property subject to a short-term lease will not be subject to the the bill. For purposes of this rule, the term of a lease begins when property is first used under it.

Different short-term lease rules apply for the depreciation provisions of the bill and for the investment credit provisions of the bill. Under the bill's depreciation provisions, in the case of property other than 15-year real property, a lease of not greater than one year or 30 percent of the property's ADR mid-point life (but not greater than 3 years) will qualify as a short-term lease. In applying the bill's depreciation provisions with respect to 15-year real property, a lease of not greater than 3 years will qualify as a short-term lease.

Under the bill's investment credit provisions, property leased to a tax-exempt entity (or a related tax-exempt entity) for less than 6 months in the lessor's taxable year will be treated as leased for a short term. However, property described in ADR class 13.0 (relating to certain assets used in offshore drilling for oil and gas) and containers, as defined in section 48(a)(2)(B)(v), will be treated as leased for a short term if the term of the lease does not exceed the greater of one year or 30 percent of the property's ADR mid-point life (but not in excess of 3 years).

8. Lease Term

For all purposes of the bill, the term of a lease includes all periods for which the lessee (or a related party) has a legally enforceable option to renew, or the lessor has a legally enforceable option to compel renewal, whether the lease is in fact renewed and regardless of the terms at which the lease is renewable. However, in the case of 15-year real property, an option to renew by the lessee at fair rental value, as determined at the time of renewal, will not be treated as an option to renew.

The bill leaves open the possibility, as under present law, that the term of a subsequent lease could be included in the term of the original lease if the circumstances indicate that the parties, upon executing the original lease, had informally agreed that there would be an extension of the original lease. An extension at a rental rate differing materially from the market rental rate at the time of the extension would suggest that the parties had such an informal agreement.

Under the bill, if a tax-exempt entity (or a related party) at substantially the same time or as part of one arrangement enters into several leases covering the same or substantially similar property,

each having a different term, the original lease term will be treated as running through the term of the lease which has the latest expiration date of the several leases. That rule will not apply merely because the parties enter into a new lease at fair rental value at the end of the primary lease term.

9. Definition of Related Party

The following related party rules apply under the bill:

Each governmental unit and each agency or instrumentality of a governmental unit is related to each other such unit, agency, or instrumentality the rights, powers, and duties of which derive in whole or in part, directly or indirectly, from the same sovereign authority. Therefore, a multi-State commission is related to each of its member States, since the commission will be deriving its authority from those States. For purposes of this rule, the United States, each State (including the District of Columbia), each possession of the United States (including Puerto Rico), and each foreign country is a separate sovereign authority. Therefore, a city in one State will not be related to a city in another State under the rule. However, each city in a foreign country will be treated as related to every other governmental unit, agency, or instrumentality in that foreign country.

Any entity (other than a governmental unit or an agency or instrumentality of such a unit) is related to any other person if the two have (a) significant common purposes and substantial common membership or (b) directly or indirectly, substantial common direction. For example, the local chapter of a national fraternity or of the Red Cross is related to its national organization.

Any tax-exempt entity is related to any other entity if either owns 50 percent or more of the capital interests or the profit interests in the other. For example, a foreign person is related to its wholly-owned subsidiary and any corporation that owns 50 percent or more of the value of its stock, and a section 501(c)(3) organization is related to any corporation 50 percent or more of the stock of which it owns. For purposes of this rule, an entity treated as related to any other entity under either of the two foregoing rules will be treated as the one entity. For example, assume that each of 10 cities within 1 State own 10 percent of a corporation. The State, each city, and the corporation are related parties.

Any tax-exempt entity is related to any other tax-exempt entity with respect to a particular transaction if such transaction is part of an attempt to avoid the application of section 46(f), section 48(a)(4), section 48(a)(5), section 48(g)(2)(B)(vi), or section 168(j).

10. Exceptions

The bill does not apply to mass commuting vehicles exempted from most of TEFRA's amendments to the safe harbor lease provisions. See section 208(d)(5) of P.L. 97-248. Furthermore, the bill does not apply to property described in section 208(d)(3)(E) of P.L. 97-248, as amended by P.L. 97-448 (relating to certain boilers and turbines of rural electric cooperatives). Nor does the bill apply to property described in section 168(f)(12)(C)(ii) (relating to certain sewage or solid waste disposal facilities) of present law if a ruling request re-

lating to the tax consequences of the use of such property by a tax-exempt entity was filed on or before May 23, 1983.

The committee bill does not apply to any motion picture film or video tape described in section 48(k)(1)(B) (relating to motion picture films and video tapes created primarily for public entertainment or educational purposes) used by any foreign person or entity. However, no inference is intended as to whether motion picture films and video tapes can qualify as recovery property.

Effective Date

General

The bill applies to property placed in service by the taxpayer after May 23, 1983, except to the extent acquired by the taxpayer subject to a lease in effect on May 23, 1983. The bill also applies to property placed in service by the taxpayer by May 23, 1983, and used pursuant to a lease entered into or renewed after May 23, 1983. For purposes of the preceding sentence, a lease will not be treated as entered into or renewed after May 23, 1983, merely by reason of the exercise by a lessee of a written option, or performance under a contract, enforceable against the lessor on May 23, 1983, and at all times thereafter. Furthermore, property will not become tax-exempt use property merely because a lessee under a lease entered into by May 23, 1983, subleases the property after May 23, 1983. In the case of 15-year real property leased to the United States Postal Service, the rules described in this paragraph are to be applied by substituting October 31, 1983, for May 23, 1983, each place it appears.

Transitional rules

General

The bill does not apply to property used by a tax-exempt entity pursuant to one or more written contracts binding on May 23, 1983, and at all times thereafter, which required the taxpayer (or a predecessor in interest under the contract) to acquire, construct, reconstruct, or rehabilitate the property and the tax-exempt entity (or a tax-exempt predecessor in interest under the contract) to use the property.

For example, assume that on February 1, 1983, a tax-exempt entity enters into a binding contract to have a building constructed. Construction is to be completed on January 15, 1984. On May 1, 1983, the tax-exempt entity assigns its interest in the construction contract to corporation X and enters into a binding contract to lease the building back from corporation X upon its completion. The general transitional rule applies. However, the general transitional rule would not apply if the assignment and entering into of the binding contract to lease did not occur until after May 23, 1983.

As a further example, assume that a tax-exempt entity has owned and occupied all of a building for years. On May 1, 1983, the tax-exempt entity enters into a binding contract with corporation Y pursuant to which the tax-exempt entity, on July 1, 1983, will sell the building to corporation Y and lease it back. The general transitional rule applies. The result would be the same even if cor-

poration Y assigns its entire interest in the contract to corporation Z, or contributes it to a partnership of which it is a member, on June 1, 1983. And the result would be the same if the tax-exempt entity assigned its interest in the lease to another tax-exempt entity on June 15, 1983.

A contract is binding only if it is enforceable under State law against the taxpayer (or a predecessor) and does not limit damages to a specified amount as, for example, by a liquidated damages provision. A contract that limits damages to an amount equal to at least 5.0 percent of the total contract price will not be treated as limiting damages. A contract is binding even if subject to a condition, so long as the condition is not within the control of either party (or a predecessor). A contract will not be treated as ceasing to be binding merely because the parties make insubstantial changes in its terms or if any term is to be determined by a standard beyond the control of either party. Finally, a contract which imposes significant obligations on the taxpayer (or a predecessor) will not be treated as non-binding merely because some terms remain to be negotiated. For example, if a corporation and a tax-exempt entity enter into a legally enforceable contract on May 1, 1983, pursuant to which the corporation agrees to buy a building from the tax-exempt entity and then lease it back, the contract will be treated as a binding contract to use notwithstanding the fact that some terms of the lease have not yet been set.

On the other hand, a binding contract to acquire a component part for a larger piece of property will not be treated as a binding contract to acquire the larger piece of property. For example, if a tax-exempt entity entered into a binding contract on May 1, 1983, to acquire a new aircraft engine, there would be a binding contract to acquire only the engine, not the entire aircraft.

Specific projects

The bill identifies several projects that will not be subject to the bill. Those projects are identified, in part, by reference to particular actions taken. This transitional rule is to apply to property included in a project only to the extent that the project is completed substantially as contemplated at the time of and in the action identified.

Appropriations

The bill does not apply to personal property leased to the United States (or an agency or instrumentality thereof) if an express appropriation has been made for rentals under the lease for the fiscal year 1983 prior to May 24, 1983, but only if neither the United States nor any agency or instrumentality thereof has provided any indemnification against loss of any tax benefits under the lease.

Revenue Effect

These provisions will increase fiscal year budget receipts by $511 million in 1984, $1,011 million in 1985, $1,848 million in 1986, $3,161 million in 1987, and $5,032 million in 1988.

D. Tax Treatment of Capital Gains and Losses

1. Decrease in Holding Period Required for Long-Term Capital Gain Treatment (sec. 136 of the bill and sec. 1222 of the Code)

Present Law

Gains or losses on sales or exchanges of capital assets held for more than 12 months are considered long-term capital gains or losses (sec. 1222). for noncorporate taxpayers, only 40 percent of net long-term capital gains are included in taxable income, while 100 percent of net short-term gains are included. However, net capital losses are deductible against $3,000 of ordinary income to the extent of 100 percent of short-term losses and 50 percent of long-term losses.

For corporate taxpayers, net long-term capital gains are subject to an alternative tax rate of 28 percent, while net short-term gains are taxed at ordinary corporate rates. Capital losses of corporations are not deductible against ordinary income.

Reasons for Change

The differential tax treatment of short-term and long-term transactions creates incentives for investors not to realize short-term gains. Studies of capital asset sales data confirm that investors are "locked-in" to investments because they do not desire to realize short-term gains. This reduces capital market efficiency because investors hold assets longer than they otherwise might in the absence of tax considerations. Prior to 1977, the holding period was 6 months. By reducing the capital gains holding period from 12 to 6 months, the committee believes that the lock-in effect and its adverse impact on capital market efficiency will be reduced.

Explanation of Provision

The holding period for determining whether a gain or loss on the sale or exchange of a capital asset or certain business property is long-term or short-term is reduced from 1 year to 6 months. Thus, property held for more than 6 months will be eligible for long-term capital gain or loss treatment.

Effective Date

The amendment applies to assets acquired after November 1, 1983.

2. Deduction of Capital Losses Against Ordinary Income (sec. 137 of the bill and secs. 1211 and 1212 of the Code)

Present Law

Capital losses of individuals are deductible in full against capital gains. In addition, unused capital losses may be carried forward to future years indefinitely. A limited amount of capital losses may also be deducted against ordinary income. The present $3,000 limitation was adopted by the Tax Reform Act of 1976, which increased the limitation, from $1,000 under prior law, to $2,000 in 1977 and $3,000 in 1978 and subsequent years. For losses from years after 1969, only 50 percent of net long-term capital losses in excess of net short-term capital gains may be deducted from ordinary income. Thus, $6,000 of net long-term capital losses is required to offset $3,000 of ordinary income.

Reasons for Change

By limiting the amount of capital losses that can be used to offset ordinary income, but allowing an unlimited capital loss carryforward, the capital loss rules create an incentive for continued capital investment by taxpayers incurring capital losses. In addition, the limitation on the deduction of capital losses against ordinary income protects the tax base, since it is within the discretion of taxpayers to time their dispositions so as to realize capital losses while deferring the realization of capital gains. The committee believes these policies can be served bettern by reducing the $3,000 limitation of present law to $1,000.

In addition, in the interests of tax simplification, it is now appropriate to repeal the special rules applicable to unused capital losses incurred before 1970, since taxpayers have had 14 years to use these losses to reduce taxable income, and the special rules add considerable complexity to individual tax forms.

Explanation of Provision

The bill would reduce the ceiling on the deduction of net capital losses against ordinary income from $3,000 to $1,000. The special treatment applicable to capital losses sustained before 1970 would be repealed.

Effective Date

The bill applies to the deduction of capital losses against ordinary income for taxable years beginning after December 31, 1983.

3. Revenue Effect of Capital Gains and Loss Provisions

The capital gains and loss provisions together will increase fiscal year budget receipts by less than $5 million in 1984, $424 million in 1985, $307 million in 1986, $315 million in 1987, and $333 million in 1988.

E. Excise Tax on Sport Fishing Equipment and Financing of Sport Fish Restoration and Boating Safety Programs; Excise Tax on Certain Arrows (Sec. 141–144 and 146–150 of the bill)

1. Revenue Provisions

Present Law

Excise tax on fishing equipment

An excise tax equal to 10 percent of the sales price is imposed on the first sale of fishing rods, creels and reels, and on artificial lures, baits, and flies (including parts and accessories) by the manufacturer, producer, or importer of the taxable item (Code sec. 4161(a)).

Amounts equivalent to the revenues from the 10-percent excise tax on fishing equipment are appropriated (based on the prior fiscal year's tax receipts) to the States in partial reimbursement of the costs they incur in approved fish restoration and management projects, discussed below under the explanation of the sport fish restoration program (presently referred to as the Dingell-Johnson fund program).

Time for payment of tax

Treasury regulations require returns of manufacturers excise taxes, including the tax on the sale of fishing equipment, to be filed quarterly, unless the Internal Revenue Service requires more frequent filing by an individual taxpayer (Treas. Reg. sec. 48.6011(a)-1). Quarterly returns are due on the last day of the first month after the end of the quarter (Treas. Reg. sec. 48.6071(a)-1).

Although most Federal excise tax returns are filed on a quarterly basis, Treasury regulations generally require monthly, or semimonthly, payment of the tax (Treas. Reg. sec. 48.6302(c)-1). If a taxpayer is liable in any month for more than $100 of manufacturers excise tax, the taxpayer must deposit the amount on or before the last day of the next month at an authorized depository or at the Federal Reserve Bank serving the area in which the taxpayer is located. If a taxpayer had more than $2,000 in manufacturers excise tax liability for any month of a preceding calendar quarter, these taxes must be deposited for the following quarter (regardless of amount) on a semimonthly basis. These taxes must be deposited by the ninth day following the semimonthly period for which they are deposited.

Taxes on motorboat fuels

Taxes at a rate of 9 cents per gallon are imposed on gasoline and special motor fuels used in motorboats. For fiscal years 1983 through 1988, up to $45 million per year (but not to exceed a total

balance of $45 million in the fund at any time) of the revenue from these taxes is to be transferred into the National Recreational Boating Safety and Facilities Improvement Fund (the "Boating Safety Fund"). The balance, if any, is to be transferred to the Land and Water Conservation Fund.

Import duties on fishing equipment and yachts and pleasure craft

Duties at varying rates are imposed on the importation of specified articles of fishing equipment (19 U.S.C. 1202). Duties are also imposed on the importation of certain yachts and pleasure craft (19 U.S.C. 1202). Revenues from these import duties are deposited in the general fund of the Treasury.

Reasons for Change

Excise tax on sport fishing equipment

In expanding the list of items subject to the excise tax on sport fishing equipment, the committee is concerned that domestic producers of fishing equipment have been disadvantaged by the present law method of imposing tax at the manufacturer or importer level. Specifically, the committee understands that some importers of fishing equipment have been able to reduce the sales price on the first sale after import (and hence the amount of tax) to an artificially low level, resulting in their receiving an unfair advantage over domestic producers. To provide equity among all taxpayers, the bill imposes the tax on the last sale before retail for both domestic and imported equipment. Special rules apply in the case of importer-retailers and certain mass merchandising firms.

The committee believes that the 10-percent excise tax on fishing equipment should be expanded to cover other sport fishing equipment so that all purchasers of such equipment will contribute to the financing of the Federal-State sport fish restoration program. In the case of fishing tackle boxes, which may be used for both fishing and other purposes, the committee decided to impose the tax at a special 3-percent rate. The committee further decided to impose the tax at a special 3-percent rate on electric outboard boat motors, which are used primarily in sport fishing. Further, the committee decided to impose the tax at a special 3-percent rate (rather than 10 percent rate) on certain fishfinders and to limit the maximum tax on any fishfinder to $30 because these devices may be used both as depth finders (navigational aids) and as devices for locating fish.

The committee is concerned that, because of the seasonal nature of sport fishing equipment sales, expansion of this tax may cause difficulties for small manufacturers who sell directly to retailers. Accordingly, the committee decided to provide an extension of time for payment of the tax by small manufacturers (i.e., those having gross receipts of $100,000 or less for the preceding calendar year). This extended payment time, however, is not to be viewed as a precedent for other payors of Federal excise taxes.

Additional revenue sources for sport fish restoration program

The committee recognizes the need for additional revenues for the Federal-State sport fish restoration program. In addition to the

revenues from the expanded excise tax on sport fishing equipment, the committee determined that it is appropriate to transfer revenues from the existing import duties on fishing equipment and on yachts and pleasure craft to the new Sport Fish Restoration Account of the Aquatic Resources Trust Fund (discussed below). Further, the committee believes that the revenues from the existing excise taxes on motorboat fuels should be reallocated so that the excess of such revenues over the $45 million per year allocated to the boating safety programs (with the exception of the first $1 million of such excess) should be allocated to the new Sport Fish Restoration Account.

Explanation of Revenue Provisions

Imposition of tax on last sale before retail

The committee bill replaces the present manufacturers excise tax on fishing equipment with a new, expanded tax imposed on the last sale before retail of sport fishing equipment. Therefore, sales of sport fishing equipment by manufacturers, producers, and importers generally will not be taxable unless they are direct sales to retailers. Sales by wholesale distributors, on the other hand, generally will be taxable.

The tax will be imposed at a 10-percent or 3-percent rate on the sales price of the taxable equipment. The committee bill provides that rules similar to the constructive sales price rules of Code section 4216 will apply in determining sales price in cases involving sales between related parties. The committee intends, for example, that these rules apply to sales for less than the article's fair market value between a wholesale distribution subsidiary of a mass merchandising company and a retail store under common ownership.

A special rule is provided where the last sale before retail occurs before importation of the taxable equipment. In such cases, the tax will be imposed on the importer at the point of entry into the United States. A further special rule is provided under which certain leases are treated as sales.

Expansion of articles subject to 10-percent tax

The committee bill expands the articles of sport fishing equipment subject to excise tax at a 10-percent rate, and classifies the articles into five main categories:

Fishing rods and poles (and component parts)

The term fishing rods and poles means any tube or shaft-like device made of natural, synthetic, or other material which is designed or used to cast, troll, or otherwise present a bait or lure to fish. It is not the intention of the committee to tax bamboo poles that are not designed or intended for use in fishing; however, any pole intended for attaching a fishing line to, or through, is to be considered to be a fishing rod or pole. "Component parts" means rod handles, guides, reel seats, blank rods, tip-tops, ferrules, or any other devices which are designed to be attached to such poles or rods for use in fishing.

The term fishing reels means any mechanical device which can be attached to rods or poles and is used or designed for dispensing and retrieving fishing line. The term includes reels used in fly fishing and also reels or spools which are employed for dispensing and retrieving the line attached to arrows and spears used in fishing.

The term fly fishing lines and other fishing lines not greater than 130-pounds test means all lines, either monofilament, multifilament, synthetic, organic, or inorganic, including metal lines, which are used or designed for the purpose of attaching lures, hooks, flies, bobbers, sinkers, and any other item of terminal tackle, including lines to attach items of terminal tackle to one another, such as leaders. Fishing lines over 130-pounds test (i.e., lines able to suspend a 130-pound weight without breaking or stretching more than 5 percent of line length while suspending that weight) are not taxable under the committee bill. This limitation is made because the committee understands that commercial fishermen primarily use fishing line greater than 130-pounds test, while sport fishermen generally use lines equal or less than 130-pounds test.

The term fishing spear means any tube or shaft-like device ending in a sharp tip and designed for the purpose of spearing fish. A taxable spear gun is any device designed for propelling a shaft or tube-like item through the water for the purposes of spearing fish. A fishing spear tip is any device designed to be attached to a shaft or tube-like device which ends in one or several sharp tips.

Items of terminal tackle

Items of terminal tackle subject to the 10-percent tax include, but are not limited to:

(1) Leaders, i.e., items used for attaching the end of a fishing line to a hook or lure or any other device of terminal tackle (a leader may include, but is not limited to, fishing lines, swivels, and snaps);

(2) Artificial lures, i.e., all artifacts (of whatever materials made) that simulate an article considered edible to fish or that are otherwise intended to induce a fish to attempt to confront, swallow, bite, or consume said device, and that are designed to be attached to a line (a lure usually includes one or more attached hooks);

(3) Artificial baits, i.e., any baits that simulate an article considered edible to fish and that are designed to be attached to a hook or lure (but not including preserved packaged natural baits);

(4) Artificial flies, i.e., hooks less than size 6/0 (i.e. less than 2-1/8 inches in length as measured from the top of the shank to the bottom of the bend in the hook) to which feathers, beads, lead, or other items are attached to make said items resemble insects or other organisms which are considered edible to fish and that are designed to be attached to a fishing line, leader, swivel, or snap;

(5) Fishing hooks smaller than size 6/0, i.e., any curved or bent metallic device which terminates in a sharp point for the purpose of catching, holding, or pulling fish or fishing bait, and which is smaller than size 6/0 (less than 2-1/8 inches as measured from the top of the shank to the bottom of the bend in the hook);

(6) Bobbers, i.e., any device used as a means to suspend a fishing line or lure in the water column, or which can be used to track visually the location and status of fishing line and associated hooks

and bait, and which can be attached to a fishing line (the term bobbers includes articles made of plastic, cork, or other material);

(7) Sinkers, i.e., devices wholly or in part made of lead or other metallic substances which are designed to attach to fishing lines or items of terminal tackle with the intention of or causing the terminal tackle to descend into the water column;

(8) Snaps, i.e., a catch, clip, or fastening device which is designed at one end to tie onto the end of a fishing line and to attach, by means of a clasp at the other end, items of terminal tackle;

(9) Drayles, i.e., any article made, wholly or in part, of lead or other metallic substances which can be tied or otherwise attached to the end of a fishing line to which is attached leaders or other items of terminal tackle and which is designed to be trolled behind a boat, such that the line or terminal tackle descends into the water column; and

(10) Swivels, i.e., devices of terminal tackle which are designed such that fishing line can be attached to either end and so that the ends of the fishing line can pivot freely.

Certain items of fishing supplies and accessories

The following items of fishing supplies and accessories are subject to the 10-percent excise tax:

(1) Fish stringers, i.e., articles designed for or sold as devices for attaching fish through the opercular opening and mouth, including devices consisting of a series of metal or plastic clips as well as cords consisting of a ring and threader connected by a cord;

(2) Creels, i.e., all portable containers of whatever material made that are designed for storing and carrying fish from the time they are caught until such time as they are removed from the container for consumption or preservation;

(3) Bags, baskets, and other containers designed to hold fish, including such items as collapsible baskets or similar devices made of any material and which are designed to be hung over the side of the boat to keep fish captive and alive in the water;

(4) Portable bait containers, i.e., any device specifically designed or sold as an article to hold or transport bait such as minnow buckets and grasshopper cages, or any other device designed specifically to hold worms, insects, frogs, etc., in connection with fishing activities;

(5) Fishing vests, i.e., garments designed for storing various lures, flies, hooks, and other fishing paraphernalia and which may also have the capacity to store fish (the term fishing vest includes vests with flotation capacity but not those vests that are solely intended as flotation devices);

(6) Landing nets, i.e., items consisting of a handle connected to a hoop, which hoop is covered by a bag-type net, and which items are designed primarily for scooping a hooked fish out of the water and into a vessel or onto shore;

(7) Gaff hooks, i.e., devices consisting of a handle and hook for holding or lifting fish into a vessel once they are brought to the boat on the end of a fishing line;

(8) Fishing hook disgorgers, i.e., any implement designed solely for use in removing fishing hook(s) from the mouth, gill, arches, or stomach of fish; and

(9) Dressing for fishing lines and artificial flies, i.e., any substance applied onto fishing lines or artificial flies designed to enhance the flotation of the line or fly or otherwise designed to attract fish to the artificial fly.

Fishing tip-ups and tilts

The term fishing tip-ups and tilts means devices consisting of such parts as a spool on a spindle and a spring-mounted flag on opposite ends of a vertical pole with cross members to support the pole over a hole in the ice, or any other such device designed to alert a fisherman when a fish is either hooked or in the process of attempting to eat the bait on a hook or bite a bait or lure.

Other fishing equipment

Certain other types of fishing equipment are also subject to the 10-percent tax, including—

(1) Fishing rod belts, i.e., articles which fasten around or near the waist and which are designed for placing the butt end of a rod or pole in a cup-like depression to aid in holding or handling of a rod or reel.

(2) Fishing rod-holders, i.e., devices which are portable and can either be inserted into beaches or clamped onto boats and which hold a rod or pole in a stationary position relative to the boat or beach.

(3) Fishing harnesses, i.e., articles worn by an angler to transmit muscular power to the rod or to absorb strain. Fishing harnesses usually are made of canvas, leather, and/or similar materials, and have straps with devices that can be fastened to the reel and/or sockets into which the rod butt may be seated.

(4) Fish fighting chairs, i.e., a heavily built chair designed to have a footrest, rod holders, and a swivel base attached and which is usually permanently installed in a suitable fishing boat for the purpose of fighting deep sea fish with rod and reel.

(5) Fishing outriggers, i.e., a device, or pair of devices, attached to a boat consisting of a braced rod or tube with a means for attaching the fishing line out and away from the boat for trolling purposes in such a way that when the fish strikes the rolled bait, the line is released from the outrigger so that the fish may be fought directly with rod and reel.

(6) Fishing downriggers, i.e., devices used for submerging and lowering the fishing line and bait down and away from a boat while trolling. A downrigger usually consists of a boom and reel attached to the boat supporting a cable and weight with a means for attaching the fishing line in such a way that when a fish strikes the trolled bait, the line is released from the weight so that the fish may be fought directly with rod and reel.

Three-percent rate on tackle boxes, fishfinders, and electric outboard boat motors

Tackle boxes

The committee bill imposes the excise tax on sport fishing equipment at a special 3-percent rate on tackle boxes, i.e., all portable containers of whatever material made that are primarily designed

or intended to be used as items in which to store or organize fishing paraphernalia such as hooks, lures, flies, sinkers, bobbers, etc., until such time as these items are placed on the fishing line, rod, or reel.

Fishfinders

The committee bill imposes the new tax at a special 3-percent rate on certain fishfinders. The amount of tax imposed under this provision may not exceed $30 per item.

Fishfinders subject to tax generally include all sonar devices suitable for finding fish. An exemption is provided, however, for sonar devices which are graph recorders, digital type devices, or meter readout devices. In addition, any combination sonar device which includes a meter readout or graph recorder is not subject to tax. Other combination devices (e.g. a combination flasher and digital device) will be taxable.

Electric outboard motors

The committee bill also imposes the tax at a special 3-percent rate on electric outboard boat motors.

Treasury regulations

The committee recognizes that certain sonar devices and utility boxes (tackle boxes) are primarily designed or intended to be used for purposes other than sport fishing. For instance, sonar devices may determine the depth of water under a boat and the type of water bed as an aid to navigation and safe boating. Utility boxes (tackle boxes) may be used to store a wide range of items, such as including tools, which are unrelated to catching fish. The committee intends that the tax be imposed only upon those items which are primarily designed or intended to be used for sport fishing, and not upon those items primarily designed and used for other purposes. Accordingly, the bill provides that, pursuant to Treasury regulations, articles similar to tackle boxes and fishfinders which are not primarily designed or intended to be used for sport fishing shall be delineated to insure that, to the extent practicable they are not subject to tax. The committee anticipates that these regulations will provide that articles advertised as fishfinders or tackle boxes will be taxable as such.

Time for payment of excise tax on sport fishing equipment

The committee bill extends the time for paying the excise tax on sport fishing equipment for manufacturers (but not other taxpayers) having gross sales receipts of $100,000 or less for the preceding calendar year. Under the bill, these manufacturers are excused from the deposit requirements otherwise applicable under Code section 6302. These manufacturers generally will be allowed to make tax payments on a quarterly basis. For manufacturers having gross sales receipts of more than $100,000 for the preceding calendar year, the bill retains the present law excise tax payment schedule.

The committee bill does not amend the time prescribed under present law for filing of sport fishing equipment excise tax returns by any taxpayers or the time for payment of excise taxes on articles other than sport fishing equipment.

Transfer of revenues from import duties on fishing tackle and on yachts and pleasure craft

An amount equivalent to the revenues received from the import duties on fishing equipment and on yachts and pleasure craft is to be dedicated to the sport fish restoration program, rather than being retained in general revenues.

Reallocation of motorboat fuels tax receipts

Revenues from the existing excise taxes on gasoline and special motor fuels used in motorboats are to be reallocated between the sport fish restoration program, the Federal boating safety program, and the Land and Water Conservation Fund. This reallocation is explained more fully in item 2, "Trust Fund Provisions," following.

Effective Dates

The sport fishing equipment excise tax provisions of the bill, including the changes in the point of imposition of that tax, generally apply with respect to articles sold after September 30, 1984. However, the imposition of the tax on tackle boxes and fishfinders is effective on October 1, 1985.

Revenue Effect

These provisions will increase gross fiscal year budget receipts by $16 million in 1985, $17 million in 1986, and $19 million in each of 1987 and 1988. Net fiscal year budget receipts (after income tax offsets) are estimated to increase by $12 million in 1985, $13 million in 1986, and $14 million in each of 1987 and 1988.

2. Trust Fund Provisions

Present Law

Present law does not provide an established trust fund for the sport fish restoration and Federal boating safety programs. Instead, these programs are funded by an appropriation from general Treasury funds of amounts equivalent to specific tax revenues (in the case of the sport fish restoration program) or by appropriation to a special "fund" not having the status of an established trust fund (in the case of the Federal boating safety program).

Sport fish restoration program

The Act of August 9, 1950 (presently referred to as the Dingell-Johnson Act) provides for cooperation between the Federal Government and State fish and game departments. Although the Act did not establish a separate fund for sport fish restoration purposes, appropriations for this purpose are linked to specific tax revenues. Limits are placed on State expenditures of Federally appropriated funds until the State has passed laws governing the conservation of fish and the State meets other requirements.

Under present law, an amount equivalent to revenues from the 10-percent excise tax on fishing equipment is authorized to be appropriated (under 16 U.S.C. sec. 777b) to carry out fish restoration and management projects. The appropriation is based on the prior year's tax receipts. The appropriation for any fiscal year continues to be available for the succeeding fiscal year. If the amount apportioned to any State is unexpended or unobligated at the end of the period for which it is available, this amount is then authorized to be made available for expenditure by the Secretary of the Interior on the research program of the Fish and Wildlife Service.

Any State that wishes to receive any of these appropriations must submit to the Secretary of the Interior a program or project for fish restoration. Amounts are appropriated to reimburse States for up to 75 percent of the cost of approved projects. Approved projects include research into problems of fish management and culture, surveys and inventories of fish populations, restocking waters with game fishes according to natural areas, and acquisition and improvement of fish habitats that provide access for public use. The amount of assistance for these programs is determined by a statutory formula.

A portion of each annual appropriation is available to the Secretary of the Interior to defray expenses of administering the program and of aiding in the formulation, adoption, or administration of any compact between two or more States for the conservation and management of migratory fishes in marine or fresh waters. The remainder of the appropriation is required to be apportioned to the States as follows:

25-551 O—83——7

(1) 40 percent in the ratio which the area of each State, including coastal and Great Lakes waters, bears to the total area of all the States; and

(2) 60 percent in the ratio which the number of persons holding licenses to fish for sport or recreation in the State in the second fiscal year preceding the fiscal year for which the apportionment is made bears to the number of such persons in all the States.

No State is permitted to receive less than one percent or more than five percent of the total amount apportioned. Puerto Rico, Guam, American Samoa, the Commonwealth of the Northern Mariana Islands, and the Virgin Islands may also received limited amounts of these revenues.

National Recreational Boating Safety and Facilities Improvement Fund ("Boating Safety Fund")

The National Recreational Boating Safety and Facilities Improvement Fund ("Boating Safety Fund") was enacted on October 14, 1980 (P.L. 96-451) (the "1980 Act") to provide a source of funding for Federal recreational boat safety and facilities improvement projects. Before this time, all funds attributable to the excise taxes on gasoline and special motor fuels used in motorboats were transferred periodically into the Land and Water Conservation Fund.

The 1980 Act provided financing for the Boating Safety Fund for fiscal years 1981 through 1983. The Highway Revenue Act of 1982 (Title V of the Surface Transportation Assistance Act of 1982, P.L. 97-424) extended the Boating Safety Fund through fiscal year 1988, and increased the amounts to be transferred into the Fund (as indicated below).

Under present law, the Secretary of the Treasury is authorized to pay into the Boating Safety Fund certain amounts equivalent to the motorboat fuels taxes received on or after October 1, 1980, and before October 1, 1988. The aggregate amount transferred cannot exceed $45 million for each of fiscal years 1983 through 1988. Additionally, the maximum amount permitted to be held by the Fund at any time cannot exceed $45 million. Any excess motorboat fuels tax receipts are transferred into the Land and Water Conservation Fund, discussed below.

Amounts in the Boating Safety Fund are available, as provided in appropriation acts, for carrying out the purposes of the Federal Boat Safety Act of 1971 (46 U.S.C. 1476). Under that Act, as amended in 1982 by the Highway Revenue Act, the Secretary of Transportation is provided with authority to contract with the States to implement and administer boating safety programs. Approval of specific elements of a State program by the Secretary of Transportation is deemed to be a contractual obligation of the United States.

Under section 26 of the Federal Boat Safety Act, the Secretary of Transportation may allocate and distribute amounts from the Boating Safety Fund to any State that has a State recreational boating safety and facilities improvement program if that program meets certain standards and the State provides matching funds. Currently, one-third of the revenue available for allocation and distribution is to be allocated for recreational boating safety programs and two-

thirds is to be allocated for recreational boating facilities improvement programs.

Available Boating Safety Fund amounts are allocated and distributed to the States for recreational boating safety programs and facilities improvement programs as follows: one-third allocated equally among eligible States; one-third allocated among eligible States who maintain an approved State vessel numbering system according to number of vessels; and one-third allocated to eligible States according to the amount of State funds expended or obligated for State boating safety programs or boating facility improvement programs.

Land and Water Conservation Fund

On September 3, 1964 (P.L. 88-578), Congress established the Land and Water Conservation Fund as a separate account in the Treasury, effective January 1, 1965. Present law (16 U.S.C. 460*l*-5) provides for deposit of the following amounts in the Land and Water Conservation Fund:

(1) All proceeds, except those committed under other statutes, received from any disposal of surplus property and related personal property under the Federal Property and Administrative Services Act of 1949, as amended;

(2) Amounts equivalent to the 9-cents-per-gallon taxes on gasoline and special motor fuels used in motorboats (to the extent these revenues exceed the amount transferred to the Boating Safety Fund);

(3) Revenues from Federal recreation fee collections (since January 1, 1981);

(4) If appropriated, amounts necessary to make the income of the Fund not less than $900 million for fiscal year 1978 and for each fiscal year thereafter through September 30, 1989; and

(5) To the extent that the appropriated sums are not sufficient to make the total annual income of the Fund equivalent to the amounts stated above, an amount sufficient to cover the remainder from miscellaneous receipts under the Outer Continental Shelf Lands Act (43 U.S.C. 1331 et seq.).

The general purposes of the Land and Water Conservation Fund are (1) to provide funds for and authorize Federal assistance to the States in planning, acquisition, and development of needed land and water areas and facilities, and (2) to provide funds for the Federal acquisition and development of certain lands and other areas. Monies in the Fund are available for expenditures as provided in appropriation Acts. Not less than 40 percent of annual appropriations are to be used for Federal purposes; these include activities and programs of the Bureau of Land Management, the Forest Service, the Fish and Wildlife Service, and the National Park Service. The remainder of funds appropriated are apportioned among the States on the basis of statutory formulae and criteria.

Reasons for Change

The committee believes that additional revenues should be dedicated to support the Federal-State sport fish restoration program and that this support should be accomplished through a special

fund established for that purpose. The committee further believes that such a fund should be a regular trust fund and placed in the Trust Fund Code of the Internal Revenue Code for ease of administration and oversight and to conform to the prior congressional policy of incorporating trust funds (e.g., Airport and Airway, Highway, and Black Lung Trust Funds) into the Internal Revenue Code. The committee believes that amounts appropriated for boating safety purposes should also derive from an established trust fund.

To provide funds for the sport fish restoration and boating safety programs, the committee determined that a new Aquatic Resources Trust Fund should be established having two separate accounts, the Sport Fish Restoration Account and the Boating Safety Account, each with its own earmarked revenue sources. In funding these accounts, the committee determined that up to $45 million per year (for fiscal years 1983–1988) of revenues from the taxes on motorboat fuels should continue to be dedicated to Federal-State boating safety programs. However, to provide additional revenues for sport fish restoration programs, the committee determined that motorboat fuels tax revenues in excess of the amounts transferred to the Boating Safety Account (with the exception of the first $1 million per year of such excess) should be allocated to the Sport Fish Restoration Account rather than to the Land and Water Conservation Fund as under present law.

Explanation of Trust Fund Provisions

Establishment of Aquatic Resources Trust Fund

In general

The committee bill establishes a new trust fund, The Aquatic Resources Trust Fund (to be known as the Wallop-Breaux Fund), in the Trust Fund Code of the Internal Revenue Code, to be administered by the Secretary of the Treasury. The new Wallop-Breaux Fund expands and combines funding for the present sport fish restoration and boating safety programs into a single Trust Fund. The Trust Fund will consist of two accounts, the Sport Fish Restoration Account and the Boating Safety Account, described below. The bill also makes conforming amendments necessitated by the establishment of the Aquatic Resources Trust Fund.

Under the bill, amounts equivalent to the following revenues are appropriated to the Aquatic Resources Trust Fund:

(1) Revenues from the new expanded excise tax on sport fishing equipment (both the 10-percent and the 3-percent portions);

(2) Revenues from the 9-cents-per-gallon excise taxes on gasoline and special fuels used in motorboats (other than $1 million of those revenues which will be transferred to the Land and Water Conservation Fund); and

(3) Import duties imposed on fishing equipment and on yachts and pleasure craft.

Sport Fish Restoration Account

The present sport fish restoration program is replaced by the expanded program provided by the new Sport Fish Restoration Account. This expanded program is financed by trust fund revenues

attributable to (1) the excise tax on sport fishing equipment, (2) motorboat fuels taxes (to the extent these revenues exceed the amount transferred to the Boating Safety Account and the Land and Water Conservation Fund),[1] and (3) import duties on fishing equipment and on yachts and pleasure craft.

The expenditure purposes established for the Sport Fish Restoration Account are those purposes established for the sport fish restoration program as amended by the bill. Expenditure purposes are limited to those provided by law as of October 1, 1984.

Specifically, monies in the account may be expended, subject to appropriation acts, for the purpose of restoring and managing all species of fish which have material value in connection with sport or recreation in the marine and or fresh waters of the United States, including—

(1) Such research into problems of fish management and culture as may be necessary for efficient administration affecting fish resources;

(2) Acquisition of such facts as are necessary to guide and direct the regulation of fishing by law, including the extent of the fish population, the drain on the fish supply from fishing and/or natural causes, the necessity of legal regulation of fishing, and the effects of any measures of regulation that are applied;

(3) Formulation and adoption of plans for restocking waters with food and game fishes according to natural areas or districts to which such plans are applicable, together with the acquisition of such facts as are necessary to the formulation, execution, and testing the efficacy of such plans;

(4) Selection, restoration, rehabilitation, and improvement of areas of water or land adaptable as hatching, feeding, resting, or breeding places for fish, including acquisition by purchase, condemnation, lease, or gift of such areas or estates or interests therein as are suitable or capable of being made suitable therefor, and the construction thereon or therein of such works as may be necessary to make them available for such purposes, and such preliminary or incidental costs and expenses as may be incurred in and about such works;

(5) Acquisition, development, renovation, or improvement of facilities (and auxiliary facilities necessary to insure safe use of such facilities) that create, or add to, public access to the waters of the United States for boating purposes;

(6) Aquatic resource education programs for increasing public understanding of the Nation's water resources and associated aquatic life forms; and

(7) Subject to a percentage limitation contained in the Act, for administration of the sport fish restoration program by the Secretary of the Interior.

---

[1] Under the bill, amounts equivalent to the revenues derived from the excise taxes on motorboat fuels are allocated first to the Land and Water Conservation Fund (in an amount not exceeding $1 million), and second, to the Boating Safety Account (in an amount not exceeding $45 million), with the excess being allocated to the Sport Fish Restoration Account. By contrast, under present law, these amounts are allocated first to the Boating Safety Fund (in an amount not exceeding $45 million), with the entire excess being allocated to the Land and Water Conservation Fund.

Monies in the Account will be available for expenditure by the Secretary of the Interior as provided in the Act of August 9, 1950, establishing the sport fish restoration program, and will remain available until spent.

Boating Safety Account

The National Recreational Boating Safety and Facilities Improvement Fund is replaced by a new Boating Safety Account in the Aquatic Resources Trust Fund. The Boating Safety Account is to be funded by an amount equivalent to a portion of the revenues from the excise taxes on motorboat fuels. The amount of revenues allocated to the Account cannot exceed $45 million in any fiscal year through fiscal year 1988. Additionally, no amount may be allocated to the Account if such allocation would cause the uncommitted balance of the Account to exceed $45 million.

The expenditure purposes established for the Boating Safety Account are the same as those established for the present Boating Safety Fund, as amended by the bill. Expenditure purposes are limited to those provided by section 30 of the Federal Boat Safety Act of 1971, as of October 1, 1984.

Specifically, monies in the Account may be expended, subject to appropriation acts, as follows—

(1) Two-thirds of the amount allocated to the Account in any fiscal year (i.e., up to $30 million) for State boating safety programs; and

(2) One-third of the amount allocated to the Account (i.e., up to $15 million) to the operating expenses account of the Coast Guard (including the Coast Guard Auxiliary) to defray the cost of services provided by it for recreational boating safety.

The State boating safety program purposes eligible for funding from the account are—

(1) Providing facilities, equipment, and supplies for boating safety education and law enforcement, including purchase, operation, maintenance, and repair;

(2) Training personnel in skills related to boating safety and to the enforcement of boating safety laws and regulations;

(3) Providing public boating safety education, including education programs and lectures, to the boating community and the public school system;

(4) Acquiring, constructing, or repairing public access sites used primarily by recreational boaters;

(5) Conducting boating safety inspections and accident investigations;

(6) Establishing and maintaining facilities for, and providing, emergency or search-and-rescue assistance; and

(7) Establishing and maintaining waterway markers and other appropriate aids to navigation.

Monies in the Account will be available, subject to appropriations acts, for expenditure by the Secretary of Transportation pursuant to that Secretary's contract authority, and will remain available until spent.

Land and Water Conservation Fund

An amount not exceeding $1 million per fiscal year of the revenues attributable to the excise taxes on gasoline and special fuels used in motorboats will be transferred to the Land and Water Conservation Fund. No other amendments are made by the bill to that Fund.

Effective Date

The trust fund provisions of the bill are effective on October 1, 1984.

Revenue Effect

The overall revenue effect of these provisions are indicated in the following table.

Estimated Revenues Available for Sport Fish Restoration Program Under Present Law and Under the Committee Bill, Fiscal Years 1984–1988

[In millions of dollars]

Revenue source	1984	1985	1986	1987	1988
Existing revenue source:					
Present law 10-percent excise tax on fishing equipment	38	41	44	49	53
Additional revenues:					
Expanded tax on sport fishing equipment		16	17	19	19
Transfer of import duties on fishing equipment and yachts and pleasure craft [1]		20	20	20	20
Excess motorboat fuels taxes (over that estimated going to the Boating Safety Account) [2]		[3] 20	[3] 20	[3] 20	[3] 22
Total available [4]	[3] 38	[3] 97	[3] 101	[3] 108	[3] 114

[1] Amounts now go into the general fund.

[2] Excess over the $45 million limit going to the Boating Safety Account plus the $1 million to the Land and Water Conservation Fund. Such excess amounts now go into the Land and Water Conservation Fund.

[3] This assumes that the full $45 million per year would be transferred to the Boating Safety Account. However, if as the Treasury Department assumes only $15 million is appropriated and transferred each year, there would be an additional $30 million per year available for the sport fish restoration program.

[4] Amounts are available for appropriation for the sport fish restoration program in the year following receipt.

3. Amendments to the Federal Aid to Sport Fish Restoration Act

The bill provides that all funds accruing to the sport fish restoration program are to be allocated equitably between projects that benefit marine sport fisheries and projects that benefit freshwater sport fisheries, since the funds used are being collected from both marine and freshwater boaters and fishermen.

The committee recognizes that, since all coastal States do not require marine fishing licenses, the exact calculation of the proper allocation would be virtually impossible. The procedures should be based on the most reliable and uniformly derived estimates of salt water anglers, such as the National Survey of Fishing, Hunting and Wildlife Associated Recreation published by the U.S. Fish and Wildlife Service. The committee also recognizes that it would be impracticable for States to design projects that would meet the allocation requirements exactly and intends that the guidelines allow for variance from the allocation formulae on a yearly basis as long as the States make a good faith effort to allocate the funds properly over a reasonable multi-year period, such as three years.

The bill amends Section 3 of the original Sport Fish Restoration Act to incorporate the authorization of appropriations of sums equal to the motorboat fuels taxes (less appropriations to the Boating Safety Fund Account and the Land and Water Conservation Fund), as well as the import duties imposed on fishing tackle, yachts and pleasure craft pursuant to the tariff schedules and the revenues from the new tax on sport fishing equipment.

The committee believes that the incorporation of these additional funds into the sport fish restoration program is consistent with the basic user tax concept of the program. The tax on motorboat fuels, a portion of the 9 cents a gallon tax on gasoline and other fuels, is generally is viewed as a user tax, a fixed rate tax designed to benefit the users of the product taxed. The thrust of the bill is to make the expenditure of motorboat fuels tax revenues responsive to the needs of recreational boaters and fishermen. The committee also believes that diversion of import duties collected on fishing tackle, yachts and pleasure craft to the sport fish restoration program is appropriate as a partial Federal matching of the contributions of fishermen paying the tax on fishing tackle items.

The bill amends Section 4 of the Sport Fish Restoration Act by reducing the amount available to the Department of the Interior for administration of the program from 8 percent to 6 percent. The committee believes that the administrative costs of the program reflect responsibilities that are more or less fixed and that a smaller percentage of a larger fund should, therefore, provide for adequate administration and oversight.

The bill amends Section 6 of the Act to allow the Secretary of the Interior to agree to assume 75 percent of the cost of qualified projects over a period of years, subject to the availability of funds.

This provision is designed to allow the States to schedule the payments for large scale projects over a period of years.

The bill also contains two amendments to Section 8 of the Sport Fish Restoration Act. The first would require each State to allocate a minimum of 10 percent of its annual allocation to projects that improve public access to the waters of the U.S. or improve the suitability of those waters for recreational boating. The intent of this provision is to ensure that a portion of the funds being derived from the motorboat fuels tax is used for projects that directly benefit the people who pay the tax. Thus, it is the intent of the committee that these projects be designed to accommodate motorboats. While it is obvious that not every such project can be designed for the most powerful of boats, it is the intent of the committee that these projects accommodate boats with common horsepower ratings.

The committee specifically intends that a broad range of access facilities and associated amenities qualify for construction under this set-aside. Examples of projects would include, but not be limited to: launching facilities, such as ramps and boat lifts; docking facilities; breakwaters; and fishing and boating lakes and ponds (provided power boats are permitted). The committee also intends that these funds be available for such additional amenities as fish cleaning stations, restrooms, trash receptacles and parking areas. Engineering costs, as well as the costs of environmental assessment and permit applications, could also be included in the project costs. The committee does not intend that these set-aside funds be the only source of public access, acquisition, construction, repair, or maintenance. Access and safety related facilities will also be constructed with boating safety funds and sport fish restoration expenditures. If any State does not utilize the set-aside for access, those funds will be available for the subsequent fiscal year. Any funds not used after two years will be made available to the Fish and Wildlife Service for sport fishery research projects.

The second amendment to Section 8 of the Act authorizes the use of up to 10 percent of a State's allocation under the Act for aquatic resource education programs. The purpose of this provision is to encourage programs that increase public understanding of the nation's water resources and aquatic lifeforms. The committee intends that these funds be available for a broad range of education programs, including programs designed for presentation to civic groups and volunteer organizations as well as programs designed for educational institutions.

4. Amendments to the Federal Boat Safety Act

The bill amends and restates the policies and purposes of the Federal Boat Safety Act of 1971 (P.L. 92-75, the "1971 Act"), as amended, recognizing the important role of the States in boating safety. Additional emphasis is given to the need for continued coordination and cooperation between the Federal Government and the States in administering and enforcing Federal and State boating laws. Recognition is also given to the need to use revenues generated by motorboat fuels taxes equitably and in a manner which enhances boating safety.

The bill amends the 1971 Act by eliminating the definition and the description of State recreational boating facilities programs. All references made to facilities programs are eliminated through conforming amendments.

The bill retains the authorization in present law for the Secretary of Transportation to enter into contracts to implement boating safety programs, but eliminates the authority for facilities programs. Two-thirds of the money in the Boating Safety Account is to be made available for State boating safety programs.

The Secretary of Transportation is required to establish guidelines prescribing purposes for which funds available for the boating safety programs may be used. These purposes include the provision of facilities, equipment and supplies for boating safety education and law enforcement; training and education in boating safety and the enforcement of boating safety laws; the acquisition, construction and repair of public access sites used primarily by recreational boaters; providing boat numbering or titling programs; conducting boating safety inspects and accident investigations; establishing and maintaining state capabilities to provide emergency or research and rescue assistance; and establishing and maintaining aids to navigation.

It is the intent of the committee that the types of navigation aids covered by the State programs are those that mark State waters, marinas, and other areas of concern to each local interest and do not necessarily replace the general aids to navigation function performed by the Coast Guard along our coasts and on the rivers. Further search and rescue assistance might include State expenditures not only for the usual small boat search and rescue services but also authority for States to use helicopter services and other contract or in-house services appropriate for search and rescue programs.

In addition, one-third of the money in the Account is to be available to the Secretary for expenditure each year out of the operating expenses account of the Coast Guard for services provided by the Coast Guard for recreational boating safety, including services provided by the Coast Guard Auxiliary. Funds collected will

become available to the Secretary immediately upon transfer and shall remain available until expended.

Further, the bill amends Section 202 of the Recreational Boating Fund Act of 1980 (46 U.S.C. 1479a) to eliminate references to boating facilities programs, to re-designate the Fund as the Boating Safety Account (in the Aquatic Resources Trust Fund) and to extend the deadline on making expenditures out of the renamed Account from March 31, 1984 to March 31, 1989.

5. Expansion of Excise Tax on Certain Arrows

Present Law

Under present law, an 11-percent manufacturers excise tax is imposed on the sale by a manufacturer or importer of any bow which has a draw weight of 10 pounds or more and of any arrow which measures 18 inches overall or more in length (sec. 4161(b)). Revenues from this tax are appropriated to the Federal Aid to Wildlife Program (Pittman-Robertson fund) for support of State wildlife programs.

Reasons for Change

This provision expands the present excise tax on arrows to include arrows used by crossbow hunters. The committee believes that arrows used by crossbow hunters should be subject to tax because these hunters benefit from the Federal Aid to Wildlife Program as do other hunters using other types of bows.

Explanation of Provision

Under the bill, the excise tax on arrows is expanded to include arrows less than 18 inches in overall length which are suitable for use with a taxable bow (i.e., for crossbows).

Effective Date

This provision of the bill is effective with respect to arrows sold after September 30, 1984.

Revenue Effect

This provision will increase budget receipts by a negligible amount each year.

F. Prevention of Tax Avoidance

1. Treatment of Stock Option Straddles and Other Options (secs. 111–112 of the bill and secs. 1092, 1234 and 1256 of the Code)

Present Law

The straddle rules of present law require the deferral of losses from certain actively traded personal property or positions in such property to the extent the taxpayer has unrecognized gain at the close of the taxable year on offsetting positions. Positions are offsetting if there is a substantial diminution in the risk of loss from holding one position because the taxpayer holds the other position. Stock and stock options traded on U.S. exchanges that have an exercise period less than the minimum long-term capital gain holding period are excluded from the loss deferral and other straddle rules. Because the long-term holding period is 1 year and exchange-traded options have a maximum exercise period of approximately 9 months, all such options are excluded from the straddle rules.

Gain or loss from the sale or exchange of an option by an option holder is treated as gain or loss from the sale of property that has the same character as the property to which the option relates has in the taxpayer's hands (or would have if acquired by the taxpayer). The same character rule applies to a loss from the expiration of an option (sec. 1234(a)). Such gain or loss is long-term if the option has been held by the taxpayer for more than 1 year; if not, it is short-term gain or loss.

Gain or loss from a closing transaction and gain from the lapse of an option, in the case of an option grantor, is short-term capital gain or loss (sec. 1234(b)).

If property is disposed of by the holder of an option to sell (a put), or by the grantor of an option to buy (a call), the amount paid by such holder for the option (the premium) reduces the amount realized from disposing of the property while the premium received by the grantor of the call increases the amount realized from the property disposition. The premium paid by the holder of a call increases the basis of the property received on exercise of the call and, correspondingly, the premium received by the grantor of a put reduces the basis of the property received on exercise of the put. The holding period of property acquired pursuant to the exercise of an option commences when the property is received, without regard to the period the option was in existence.

The treatment of an option holder on the sale, exchange, or lapse of an option applies to an option to buy or sell property (sec. 1234(a)) while the treatment in the case of closing transactions and lapses applicable to option grantors applies to options in property (sec. 1234(b)). It has been alleged that certain options that provide for settlement only in cash are are governed by these rules. Gain

or loss attributable to the termination of rights or obligations with respect to personal property which is (or on acquisition would be) a capital asset in the hands of a taxpayer is treated as gain or loss from the sale of a capital asset (sec. 1234A). It is not wholly clear that this rule would require capital gain or loss characterization of gains and losses from such cash settlment options.

Regulated futures contracts (RFCs) traded on domestic boards of trade designated as contract markets by the Commodity Futures Trading Commission are marked to market at the close of the taxable year and treated as 60 percent long-term capital gain or loss and 40 percent short-term capital gain or loss.

A straddle consisting of one or more RFCs and one or more positions that are not RFCs (a mixed straddle) is subject both to the loss deferral and other straddle rules while the RFC positions of the straddle are subject to the mark to market and 60/40 rules applicable to RFCs. However, a taxpayer who properly identifies a mixed straddle by the close of the first day on which an RFC included in the straddle is acquired may elect to exclude the RFC leg of the straddle from mark to market and 60/40 treatment. The entire straddle remains subject to the loss deferral and other straddle rules.

Gains and losses from closing transactions and from the lapse of options realized by an options dealer, generally one who makes a market in options, constitute ordinary income and loss to the taxpayer.

Hedging transactions, generally transactions entered into in the normal course of the taxpayer's trade or business to reduce the risk of price changes and which result only in ordinary income or loss, are excluded from mark to market and 60/40 treatment as well as from the loss deferral and other straddle rules. A hedging transaction must be clearly identified as such before the close of the day the transaction is entered into. The hedging exemption does not apply to syndicates, generally defined as partnerships or other entities (other than corporations which are not subchapter S corporations) if 35 percent or more of the losses of the entity are allocable to limited partners or limited entrepreneurs.

The loss deferral and other straddle rules do not apply to an identified straddle, all of the positions of which are acquired on the same day and which is clearly identified on the taxpayer's records by the close of such day. Further, to be an identified straddle, all of the positions must be disposed of on the same day or none of the positions may have been disposed of by the close of the taxable year, and it may not be part of a larger straddle.

Reasons for Change

The exemption from the loss deferral and other straddle rules for exchange traded stock options has resulted in extensive use of straddles in stock options to defer gains from unrelated transactions as well as gains from stock options by investors and options dealers. Limited partners in syndicates purporting to be market makers in stock options exploit the exemption to claim ordinary losses from stock options. Another form of transaction is to acquire deep-in-the-money offsetting option positions (a call option is in the

money to the extent that the option exercise price, the strike price, is less than the market value of the stock when the option is acquired and, conversely, a put is in the money to the extent the strike price exceeds the stock's value). Whether the value of the stock moves up or down, one position will result in a loss and can be closed while offsetting gain on the other position is carried into the next year. The unrealized gain can be preserved by adopting a new offsetting position to replace the loss position disposed of.

Options on RFCs are traded on domestic boards of trade. On exercise, the holder acquires either a contract to buy (a long position) or a contract to sell (a short position). Grantors, during the option period, are required, as are grantors of stock options and other exchange traded options, to deposit amounts on a daily basis to reflect increases in the value of the option, i.e., the premium, and are credited with decreases in the premium. While the holder has no obligation during the option period beyond the original payment of the option premium, he is credited with variation margin upon exercise that reflects price movements in his favor during the option period and marks his position to market at the time of exercise. The treatment of such options under present law is unclear. It may be argued that 60/40 treatment applies to such options and, if not, that option gain can be converted to 60/40 treatment by exercising the option. It is likely that those with gains may exercise the option to acquire an RFC and claim 60 percent long-term treatment attributable to gain during the option period while taxpayers with losses will terminate their positions through closing transactions, or by permitting their options to lapse, and claim 100 percent short-term loss.

Certain options call for settlement only in cash and the settlement price is based on price movement in specified property such as a stock index (e.g., the Standard and Poor's 500 stock index). It is not wholly clear that capital gain or loss results from the disposition or lapse of these options.

Explanation of Provisions

The exclusion of exchange traded stock options from the loss deferrals and other straddle rules is eliminated under the bill. Further, an interest in stock to the extent offset by a stock option is included in the definition of positions subject to such limitations. For this purpose, an interest resulting from a short sale of stock is an interest in stock.

Options on RFCs are defined as RFCs under the bill.

If one or more of the positions of an identified straddle is an option to buy property or enter into a contract, the identified straddle rules continue to apply, with the property acquired or contract entered into upon exercise of the option being treated as a position of the identified straddle. A similar rule applies to treat property or a contract as part of a hedging transaction if acquired or entered into upon exercise of an option that was part of a hedging transaction. Further, if the taxpayer is a party to an option to enter an RFC and makes the mixed straddle election with respect to such option, the election applies to an RFC position acquired on exercise of the option.

The bill clarifies present law to provide expressly for capital gain or loss treatment on gains or losses derived from cash settlement options.

Effective Date

The amendments are effective with respect to options entered into and stock or interests in stock acquired after October 31, 1983.

Revenue Effect

These provisions will increase fiscal year budget receipts by $178 million in 1984, $394 million in 1985, $94 million in 1986, $67 million in 1987, and $73 million in 1988.

2. Foreign Investment Companies (secs. 113–114 of the bill and secs. 535 and 1246 of the Code)

Present Law

U.S. taxation of foreign persons

Although U.S. corporations are subject to current U.S. taxation on worldwide income, foreign corporations are generally subject to U.S. taxation on only their U.S. source income and income from a U.S. business. Foreign corporations are generally exempt from U.S. taxation on foreign source income. A special rule applies, however, to income from the sale of commodities and futures contracts. Foreign corporations are taxable on their gains from the sale of commodities and futures contracts only when those sales are effectively connected with a trade or business in the United States. In general, by avoiding contacts with the United States, a company purchasing and selling commodities and futures contracts on U.S. markets may be able to avoid conducting a business in the United States and thus avoid U.S. tax (sec. 864(b)(2)(B)). In that event, gains from sales of commodities and futures contracts are exempt even though they have a U.S. source.

Dividends from one foreign corporation to another foreign corporation are taxable only if 50 percent or more of the paying foreign corporation's income from the last three years is U.S. business income, in which case the dividends are U.S. source income (in the same proportion as the gross income is U.S. business income) (sec. 861(a)(2)(B)).

Taxation of U.S. shareholders of foreign corporations

The United States generally imposes tax on the U.S. shareholder of a foreign corporation only when that shareholder receives the foreign corporation's earnings in the form of a dividend. That is, the U.S. shareholder of a foreign corporation generally may defer tax on that income until receipt of dividends.

The Subpart F provisions of the Code provide an exception to this general rule of deferral. Under these provisions, income from certain "tax haven" type activities conducted by corporations controlled by U.S. shareholders is deemed to be distributed to the U.S. shareholders and currently taxed to them before they actually receive the income in the form of a dividend. For this purpose, tax haven activities generally include gains from trading in futures contracts in commodities. However, the Subpart F rules apply only if more than fifty percent of the voting power in the foreign corporation is owned by U.S. persons who own (directly or indirectly) at least ten percent interests in the corporation. (Even if ownership is so concentrated that the Subpart F rules apply, the rules apply

25-551 O—83——8

only to those U.S. persons who are considered to own ten percent or more of the voting power in the foreign corporation.)

Two other, similar sets of rules, the personal holding company rules and the foreign personal holding company rules, could also subject foreign corporations or their U.S. shareholders to current taxation on passive investment income or futures trading income, but these rules apply only if five or fewer U.S. individuals own (directly or indirectly) more than fifty percent in value of the stock of a foreign corporation. In general, only one of these three sets of rules will apply to tax that income.

The accumulated earnings tax

The accumulated earnings tax is aimed at corporations accumulating income for the purpose of avoiding tax at the shareholder level. The accumulated earnings tax (which reaches a maximum rate of 38.5%) generally applies to a U.S. or foreign corporation formed or availed of for the purpose of avoiding the U.S. income tax on shareholders by accumulating earnings at the corporate level rather than distributing earnings.

Under Treasury Regulations, the tax does not apply to foreign source income (Treas. Reg. sec. 1.532-1(c)). It may be unclear whether a foreign parent corporation and a foreign subsidiary corporation (earning U.S. source income) from which the foreign parent receives dividends are subject to this tax, however. If the subsidiary distributes all its U.S. source earnings as dividends to its parent, those dividends are generally deductible from accumulated earnings. Therefore, there may be no accumulated earnings at the level of the subsidiary to which the accumulated earnings tax can apply. The parent corporation may avoid the accumulated earnings tax because all of its income is foreign source income (such as dividends from its subsidiary) not effectively connected with a U.S. trade or business.

The Internal Revenue Service may argue in such a case that imposition of an accumulated earnings tax on the earnings of either foreign corporation is appropriate. First, the statute and the Regulations allow imposition of the accumulated earnings tax if the avoidance of tax at the shareholder level is accomplished through the use of a chain of corporations. (See Treas. reg. sec. 1.532-1(a)(2).) Second, the Code gives the Secretary authority to disregard certain tax benefits associated with a corporation if the corporation was acquired for the principal purpose of evading or avoiding Federal income tax (sec. 269).

Shareholder level tax on disposition of the investment

Code rules attempt to prevent U.S. taxpayers from repatriating foreign earnings at the lower capital gains rates after deferring tax on those earnings. Gains of a U.S. person who was a ten-percent shareholder (during a five-year period) in a controlled foreign corporation on the disposition of that corporation's stock are subject to ordinary income (dividend) treatment rather than capital gains treatment to the extent of that person's share of the post-1962 earnings and profits of the controlled foreign corporation (sec. 1248). Wide dispersal of a foreign corporation's stock ownership can avoid controlled corporation status.

Another provision, the foreign investment company provision (sec. 1246), generally applies to any foreign corporation that is either (1) registered under the Investment Company Act of 1940 or (2) engaged primarily in the business of investing or trading in securities (as generally defined in that Act) when more than 50 percent of the corporation's stock (by value or by voting power) is held (directly or indirectly) by U.S. persons. When a U.S. person disposes of stock in a foreign investment company, that person is subject to ordinary income treatment to the extent of his share of the foreign investment company's earnings and profits. A foreign corporation that does not register under the Investment Company Act avoids the first of these criteria. In addition, certain case law holds that commodities do not constitute securities for purposes of that Act, so that a company that is engaged primarily in the business of investing or trading in commodities may avoid the second criterion.

Marking-to-market of futures trading income

The Economic Recovery Tax Act of 1981, Public Law 97-34, adopted a mark-to-market rule for the taxation of certain commodity futures contracts (Code scc. 1256(a)). Thus, each such regulated futures contract held by a taxpayer is treated as if it were sold or otherwise liquidated for fair market value on the last business day of the year. A maximum rate of 32 percent applies to this income. U.S. taxpayers investing through a pass-through entity (such as a limited partnership) organized in the United States in such futures contracts would be subject to this marked-to-market rule.

Foreign corporations not engaged in U.S. trade or business are not subject to the the mark-to-market rule.

Straddles

The Code defines a straddle as offsetting positions with respect to personal property. Personal property is defined to include only property (other than corporate stock) of a type which is actively traded. A taxpayer is treated as holding offsetting positions with respect to personal property if there is a substantial reduction in the taxpayer's risk of loss from holding any position in personal property because the taxpayer holds one or more other positions with respect to personal property.

Generally, the deduction of losses on positions that are part of a straddle is limited to the amount by which those losses exceed unrecognized gains on any offsetting positions. Some taxpayers have deliberately arranged to hold offsetting positions indirectly through ownership of stock in corporations owning those positions to avoid the straddle rules. That is, a shareholder seeks to deduct losses despite unrecognized gains in the hands of the corporation that offset the shareholder's losses. Often, the corporations involved in the transactions are foreign, so as to avoid U.S. tax on the gains.

Reasons for Change

A mutual fund may, using some of the rules described above, attempt to defer U.S. tax and to convert trading income (ordinarily taxed as 60 percent long-term gain and 40 percent short-term gain) to 100 percent long-term capital gain through the use of two for-

eign corporations, one of which ("the Parent") owns all the shares of the other ("the Subsidiary"). The fund establishes and operates these foreign corporations in tax haven jurisdictions, which impose no tax on their operations.

U.S. taxation of foreign persons

The Parent may trade in non-U.S. commodity markets (and will avoid having any U.S. source income), while the Subsidiary will trade in U.S. commodity markets (and will earn all the U.S. source income that either corporation earns). In general, by carefully structuring its activities, the Subsidiary may be able to avoid having a business in the United States and thus avoid U.S. tax on gains from commodity trading activities (sec. 864(b)(2)(B)).

The Parent may be able to avoid U.S. tax because it will be a foreign corporation with no U.S. source income. Its income will consist mainly of (1) dividends from the Subsidiary, which should not be U.S. source, and (2) gains from trading on non-U.S. commodities markets, which will result in foreign source income.

Taxation of U.S. shareholders of foreign corporations

The fund may plan to avoid U.S. shareholder level tax on the earnings of the Parent and the Subsidiary by having the Parent distribute no dividends. Shareholders will have to dispose of their shares to receive any income.

To decontrol these corporations for purposes of the anti-tax avoidance rules including the controlled foreign corporation rules, the Parent will restrict transfers of its shares, and it will attempt to spread ownership of its shares by U.S. persons among many such persons.

Accumulated earnings tax

The fund may plan its operations so as to try to avoid the accumulated earnings tax. It may try to benefit from the general rule that the tax does not apply to foreign source income. This is one of the primary reasons to set up two foreign corporations (the Parent and the Subsidiary) rather than one. The parties involved will argue that the Subsidiary will not be subject to the tax because it will distribute all its U.S. source earnings as dividends to the Parent. The fund will argue that there are no accumulated earnings at the level of the Subsidiary to which the accumulated earnings tax can apply. The fund seeks to avoid the accumulated earnings tax at the level of the Parent by having all the Parent's income be foreign source income.

The validity of these positions under current law, however, is unclear, and the Internal Revenue Service may argue that imposition of an accumulated earnings tax on the earnings of the Parent or the Subsidiary is appropriate.

To avoid potential challenges to its position on the accumulated earnings tax, the fund may allege that its corporate structure has no tax avoidance purpose. The issue would be one of intent.

Shareholder level tax on disposition of the investment

Under this plan, the shareholder realizes income from the investment by disposing of the interest in the offshore corporation rather

than by being paid the earnings. A major element in this plan is to permit U.S. investors in the fund to realize capital rather than ordinary gain from their investment when they sell. Such treatment would circumvent the Code's rules that attempt to prevent U.S. taxpayers from repatriating foreign earnings at the lower long-term capital gains rates after deferring tax on those earnings. The fund would plan to avoid this rule by causing such wide dispersal of the Parent's stock ownership as to avoid controlled foreign corporation status.

The fund would plan to avoid the foreign investment company provision (sec. 1246) by failing to register the Parent or the Subsidiary under the Investment Company Act and by relying on case law that holds that commodities do not constitute securities for purposes of that Act.

Marking-to-market of futures trading income

U.S. investors could avoid the marked-to-market rule by interposing foreign corporations between themselves and the investments. A similar result could be achieved through the use of a domestic corporation at the investor's level, but the corporation would be subject to the mark-to-market rules.

Committee concerns

The committee is concerned that the abusive use of tax havens by U.S. persons through transactions like those described above poses a significant threat to the U.S. tax base. While the committee recognizes legitimate uses of tax haven entities, it also recognizes that any use of tax haven entities must be carefully scrutinized. Particularly troublesome are those cases in which U.S. taxpayers use a foreign entity, which is not much more than a conduit, to shield U.S. income from U.S. tax.

Such a situation has come to the attention of the committee with the result that the committee has reviewed certain anti-abuse provisions of the Code and has found loopholes that should be closed. In particular, the committee believes that for purposes of insuring that investment income of a U.S.-controlled foreign investment company cannot be converted to capital gain, no distinction should be made between security transactions and other investment transactions. Accordingly, the committee expanded the scope of the foreign investment company rules.

Also, the committee believes it inappropriate to defer U.S. tax on the U.S. earnings of a foreign company, or to permit mere receipt of U.S.-source income by a foreign corporation and its payment to another foreign corporation controlled by U.S. persons to change the source of that income. Accordingly, the committee has amended the accumulated earnings tax rules to insure U.S. tax in such cases.

Finally, the committee believes that transparent devices, such as the use of a corporation to avoid the straddles rules, cannot be tolerated.

Explanation of Provision

Definition of foreign investment company (sec. 1246 of the Code)

The bill expands the definition of "foreign investment company" (sec. 1246), for purposes of determining when gain on the sale of shares of that stock will be ordinary rather than capital. A foreign investment company will include any foreign corporation that is engaged (or holding itself out as being engaged) primarily in the business of investing, reinvesting, or trading in securities, commodities, or any interest (including a futures or forward contract or option) in commodities or securities, at a time when 50 percent or more of the total combined voting power of all classes of stock entitled to vote, or the total value of all classes of stock, is held directly or indirectly by U.S. persons. For this purpose, "securities" are defined in section 2(a)(36) of the Investment Company Act of 1940, as amended. If that definition in the Investment Company Act is amended in the future, then the definition for Internal Revenue Code purposes will also change. A primary effect of this provision is to bring commodity trading companies within the definition of foreign investment company. The bill will generally not affect the treatment of foreign corporations registered under the 1940 Act.

Effective date.—The provision will generally apply to sales and exchanges (and distributions) after October 31, 1983. In the case of shares held on October 31, 1983, and held continuously thereafter by one taxpayer until sale, exchange, or distribution, however, the bill will apply to sales and exchanges (and distributions) made after one year after date of enactment.

Extension of accumulated earnings tax to U.S.-owned foreign corporations (sec. 535 of the Code)

The bill makes it clear that U.S. persons cannot use two or more tiers of foreign corporations to avoid the accumulated earnings tax on certain U.S. earnings. For purposes of the accumulated earnings tax rules (secs. 531-537), if more than 10 percent of the earnings and profits of any foreign corporation for any taxable year are derived from sources within the United States or are effectively connected with the conduct of a trade or business within the United States, then any distribution received (directly or indirectly) by a United States-owned foreign corporation out of those earnings and profits will be treated as derived by the receiving corporation from sources within the United States. That is, the earnings retain their U.S. source or U.S. connection in the hands of the receiving (upper-tier) corporation, so that they will be subject to the accumulated earnings tax. A similar rule applies to interest paid by a foreign corporation. If the paying corporation meets the 10-percent earnings and profits threshhold, all interest it pays to a U.S.-owned foreign corporation is U.S. source income for the purpose of the accumulated earnings tax.

The bill defines the term "United States-owned foreign corporation" to mean any corporation if 50 percent or more of the total combined voting power of all classes of stock entitled to vote, or the total value of all classes of stock, is held directly or indirectly by U.S. persons. The bill will apply only to foreign corporations. It will apply to closely held and publicly held foreign corporations alike.

Effective date.—This provision will apply to distributions received by a United States-owned foreign corporation on or after May 23, 1983. In the case of a foreign corporation that was a United States-owned foreign corporation on May 23, 1983, however, the provision will first apply in the first taxable year of the foreign corporation that begins after December 31, 1984.

Treatment of offsetting position stock (sec. 1092 of the Code)

The bill expands the definition of personal property, for purposes of the straddle rules (sec. 1092), to include offsetting position stock. It defines offsetting position stock to mean any stock of a corporation formed or availed of to take positions in personal property which offset positions taken by shareholders. This rule applies to both U.S. and foreign corporations. Therefore, a taxpayer would be required to defer losses if offsetting position stock contained unrealized gains for him or her.

Effective date.—This provision applies to positions established after May 23, 1983.

Effective Date

The effective dates for these provisions are included above in the "Explanation of Provision."

Revenue Effect

These provisions will increase budget receipts by less than $10 million annually.

3. Collapsible Corporations (sec. 109 of the bill and sec. 341 of the Code)

Present Law

In general, a collapsible corporation is one formed or availed of principally for the manufacture, construction, production, or purchase of certain types of property with the view to the sale or exchange by the shareholders of their stock (or of the liquidation of the corporation) before the realization by the corporation of a "substantial" part of the taxable income to be derived from such property. If stock in a collapsible corporation is sold, exchanged, or the corporation is liquidated in whole or in part (*i.e.*, collapsed), or in the case of certain distributions, any gain recognized by any shareholder in any such sale, exchange, liquidation, or distribution which would otherwise be long-term capital gain is considered ordinary income.

In the case of *Commissioner v. Kelley*, 293 F.2d 904 (5th Cir. 1961), affirming, 32TC 135 (1959), nonacq., 1962-1 C.B. 5, withdrawn and acq. substituted, Rev. Rul. 72-48, 1972-1 C.B. 102, the Fifth Circuit held that a corporation will have realized a "substantial" part of the taxable income to be derived from the property (thereby avoiding collapsible corporation status with respect to that property) if the corporation realizes as little as one-third of the taxable income to be derived from the property. In *Commissioner v. Kelley, supra*, the court reasoned that the substantial part requirement related to the part of the taxable income realized and that a substantial part of such income could be realized even though an even greater part of the taxable income to be derived from the property was not realized. This view of the substantial part requirement must be compared with that announced in *Abbott v. Commissioner*, 258 F.2d 537 (3rd Cir. 1958), in which the Third Circuit held that the realized part could not be substantial unless only an insubstantial part of the taxable income to be derived from the property remained unrealized.

The statute provides an exception to collapsible corporation treatment under the "70/30" rule (Code section 341(d)(2)). In general, under this rule, a shareholder who realizes gain with respect to his stock in a collapsible corporation must determine the amount of the recognized gain attributable to collapsible assets in the corporation. If this amount is 70 percent or less of his total gain for the taxable year, then none of the recognized gain is treated as ordinary income under the collapsible corporation provisions of the Code.

Reasons for Change

The committee is concerned with the opportunities for avoidance of the collapsible corporation provision provided by the rule in the case of *Commissioner* v. *Kelley, supra*, and the existing regulations interpreting the 70/30 rule. The committee believes that property which is collapsible should continue to be so treated until less than a substantial portion of the taxable income to be realized from the property remains unrealized. Thus, in general, the committee intends to adopt the *Abbott v. Commissioner, supra*, view of the "substantial part" requirement.

With respect to the 70/30 rule, the committee is concerned with the possibilities for avoiding collapsible treatment with respect to gain on the various stock dispositions subject to the 70/30 rule where a collapsible corporation has two or more separate projects. For example, assume that a corporation builds or acquires two similar inventory-type assets or projects with a view toward collapsing the corporation prior to the time it had realized a substantial part of the taxable income to be derived from either asset. Each asset is of equal value at all relevant times. The corporation is owned entirely by one shareholder. The corporation is liquidated. Under present law, if the selling shareholder caused the corporation to realize one-third of one of its assets prior to the date of the liquidation, that asset would be treated as non-collapsible for purposes of the 70/30 rule. Since less than 70 percent of the recognized gain on the stock sale would be attributable to a collapsible asset, the 70/30 rule would apply to except the sale proceeds from the collapsible corporation provisions of the Code, even though only one-sixth of the total potential income from the assets had been recognized.

Explanation of Provision

Under the bill, the collapsible corporation definition of present section 341(b)(1) would be amended. It would be explicitly stated that property otherwise collapsible will be collapsible unless at least two-thirds of the taxable income to be derived from the property is realized by the corporation. This would replace the "substantial part" standard of present law. The committee intends that no inference should be drawn from this amendment with respect to the meaning of the "substantial part" requirement of present law.

In addition, the Secretary of the Treasury would be authorized to prescribe regulations describing the extent to which all inventory, stock in trade, or property held primarily for sale to customers in the ordinary course of a trade or business (sec. 1221(1) property) would be treated as a single asset in applying the 70/30 rule. The committee intends that these regulations will insure that the two-thirds realization requirement cannot be avoided where the corporation's collapsible section 1221(1) properties are less than two-thirds realized in the aggregate but where some of its collapsible properties have been two-thirds or more realized. Thus, if the aggregate of the corporation's collapsible section 1221(1) properties is less than two-thirds realized, all of the corporation's collapsible section 1221(1) properties, including any collapsible section 1221(1) property that has been two-thirds or more realized, will be treated as collapsible property for purposes of the 70/30 rule. The commit-

tee intends that, for purposes of applying this aggregation requirement under the "70/30" rule, all property with respect to which the taxpayer has, or at any time had, a collapsible view will be treated as collapsible property (*i.e.,* property described in section 341(b)(1)) even if it is two-thirds or more realized. Section 1221(l) property which is not collapsible property, and which never was collapsible property, need not be aggregated under this rule.

Effective Date

These amendments would be effective to sales, exchanges, and distributions made after December 31, 1983. However, any property a substantial part of the taxable income from which has been realized before 1984 will be deemed to satisfy the two-thirds realization requirement and will not be aggregated with any other property in applying the 70/30 rule. In addition, if the regulations issued under this provision with respect to the 70/30 rule are not issued and effective prior to 1984, then the committee anticipates that such regulations will have an effective date providing relief with respect to the new aggregation rules under the 70/30 rule comparable to that provided by the effective date provisions of the statute.

Revenue Effect

This provision will increase fiscal year budget receipts by $7 million in 1984, $75 million in 1985, $239 million in 1986, $330 million in 1987, and $360 million in 1988.

G. Taxpayer Compliance Provisions

1. Promoter Lists of Syndicate Participants (sec. 121 of the bill and new sec. 6111 of the Code)

Present Law

Under present law, there is no explicit requirement that promoters of syndicated investments sold directly to investors maintain customer lists that may be examined by the Internal Revenue Service. As a result, promoters may not keep customer lists or the Internal Revenue Service may have to rely on its summons authority to obtain such lists.

In other contexts, present law provides means for the Internal Revenue Service to pursue taxpayers who were led into a questionable tax position through the representations of a promoter or other third party. For example, the partnership audit provisions of TEFRA enable the Internal Revenue Service to examine partnership issues in a single proceeding and to make appropriate adjustments in the individual partners' returns automatically. Elsewhere, the Code requires that income tax return preparers retain for 3 years either the returns prepared by them or a list of taxpayers for whom returns were prepared. This provision enables the Service to examine, for example, the returns prepared by a particular person if it finds a pattern of improper return preparation by that preparer.

Reasons for Change

The committee is concerned that promoters of arrangements in which the investor purchases the investments directly are profiting from the inability of the Treasury to effectively examine every return. These promoters know that even if a tax scheme they market is clearly faulty, some investors' incorrect returns will escape detection and many will enjoy a substantial deferral of tax while the Treasury searches for their returns and coordinates its handling of similar cases.

The new requirement that promoters keep lists of customers and investments will enable the Treasury to quickly identify all of the participants in related tax-shelter investments. As a result, taxpayers claiming improper treatment will not escape detection and investors in similar schemes will receive more uniform treatment.

Explanation of Provision

The bill requires that any person organizing any investment plan or arrangement, or any other plan or arrangement, or selling any interest in such a plan or arrangement, with respect to which the person makes or furnishes any statement with respect to the

allowability of any deduction or credit, the excludability of any income, or the securing of any other tax benefit by reason of holding an interest in the entity or participating in the plan or arrangement, must maintain customer lists. These lists must show the name, address, and taxpayer identification number of each person investing in each plan or arrangement which the person organizes or sells. In addition, the Secretary is given authority to require such other information as he finds necessary. These lists must enable the Secretary to identify every purchaser of a given type of investment scheme. To this end, the Secretary may require the promoter to maintain these lists by reference to specific identifying characteristics relating to their purported tax treatment. These requirements do not apply with respect to partnership interests or subchapter S share ownership because such arrangements are already subject to special audit rules under the Code. Information must be retained for seven years after it is first required to be listed.

If the Secretary determines that the list requirement of this new provision is inconsistent with, or redundant vis-a-vis, any other provision of the Code, he may provide appropriate exceptions to the list requirement. Similarly, he may provide rules to eliminate maintenance of duplicate lists under this provision.

Any promoter or salesman who is required to maintain lists under the new provisions of the bill will be subject to a penalty comparable to that imposed on income tax return preparers who fail to maintain required lists. Thus, each failure to retain a record of any particular purchaser of an investment, will be subject to a $50 penalty except when the failure results from reasonable cause and not from willful neglect. Unlike the return preparer penalty, however, the penalty for failure to maintain required promoter lists is not subject to an aggregate annual limitation.

Effective Date

This list requirement applies to investments sold after December 31, 1983.

2. Reporting with Respect to Cash Transactions and Mortgage Interest (sec. 122 of the bill and new sec. 6050H of the Code)

Present Law

Cash transactions.—In addition to the information reporting required by the Code, the Bank Secrecy Act authorizes the Secretary to require reporting of certain financial transactions. Under these rules, certain banks and other financial institutions are required to report cash transactions (including deposits and withdrawals) of more than $10,000. The Treasury regulations provide a number of exceptions to this reporting requirement. Also, persons who bring or send more than $5,000 in cash or other bearer instruments into or out of the United States must report the event to the United States Customs Service. Finally, a United States taxpayer who files a tax return is required to notify the Internal Revenue Service, where provided for on the tax return, of the existence of a foreign bank account or other foreign financial account that he controls or

in which he has an interest. If the amount in the account exceeds $1,000, then the amount must be reported on a separate form to the Treasury Department.

Bank Secrecy Act information is compiled by the Treasury Department, and made available to agents of the Internal Revenue Service.

Mortgage interest.—Under present law, interest paid on a mortgage is deductible in computing taxable income. There is, however, no requirement that the recipients of such interest provide information with respect to the payment to the Internal Revenue Service.

Reasons for Change

The committee is concerned that approximately 80 percent of the revenue lost through noncompliance is attributable to the underreporting of income. For 1981, the Internal Revenue Service estimates that taxpayers filing returns failed to report $134 billion of income and nonfilers failed to report $115 billion. This $250 billion of underreporting reduced tax receipts by an estimated $55 billion. Unreported income connected with illegal activities was estimated to result in an additional $9 billion of lost revenue. The committee believes that reporting on the spending of large amounts of cash will enable the Internal Revenue Service to identify taxpayers with large cash incomes.

In addition, the committee believes that a provision requiring recipients of mortgage interest payments in excess of $2,300 to report the interest received to the Internal Revenue Service (with a copy to the payor) will materially assist the Internal Revenue Service in verifying the accuracy of claimed mortgage interest deductions. Internal Revenue Service studies indicate that a significant percentage of all overstated deductions involves overstatement of interest deductions.

Explanation of Provision

Cash transactions.—Under the bill, any person who receives (for his own account or the account of another) cash in connection with a trade or business will be required to report on any transaction in which the amount of this cash received is $10,000 or more. A transaction subject to reporting is any receipt of cash including receipt in connection with the purchase of goods or services, the purchase or exchange of property, the opening of a deposit or credit account, the purchase of gambling chips, or any similar transaction. For this purpose, a series of related transactions will be treated as a single transaction.

This new reporting requirement is imposed with respect to any receipt of cash in connection with a trade or business whether or not the receipt constitutes income in the trade or business. Thus, reporting is required whether or not consideration is returned for the cash and whether or not the cash is received for the recipients' account or for the account of another. An exception is provided in the case of transactions subject to reporting under the Bank Secrecy Act.

The recipient of the cash will be required to report the name, address, and identifying number of the payor, the date and nature of the transaction and such other information as the Secretary may require. In addition to furnishing reports on each cash transaction to the Internal Revenue Service, the recipient of the cash must furnish each payor an annual statement aggregating the amounts of cash received from him. Such statement must be furnished on or before January 31 of the year following the year of the reportable event.

The bill defines cash for purposes of this provision as including only U.S. and foreign currency.

Mortgage interest.—Under the bill, any person who, in connection with a trade or business, receives $2,300 or more of mortgage interest payments from any person during the calendar year will be required to report the payor's, name, address, and taxpayer identification number and such other information as the Secretary may prescribe. This reporting requirement applies not only to the person entitled to the interest, but also to persons (such as service companies) who receive interest payments on behalf of another. For this purpose, mortgage interest is any interest on an obligation secured by an interest in real property (including, however, interest payable under a contract for deed) and amounts paid in lieu of interest for which a deduction is allowed. In addition to furnishing reports on mortgage interest receipts of $2300 or more for any calendar year to the Internal Revenue Service, the payment recipient must furnish to each payor an annual statement of the amount of mortgage interest received from that payor in the calendar year. Such statements are due on or before January 31 of the year following the calendar year for which the return is made.

The committee decided to require reporting only where the amount of interest exceeds $2,300 because payments in excess of that amount generally allow individual payors to claim itemized deductions.

Penalties.—The penalty for failure to make required reports will be similar to that imposed on failures to make other information reports. Thus, the penalty will be $50 per failure, subject to a maximum of $50,000 for any calendar year. The penalty is not applicable if the failure is due to reasonable cause and not to willful neglect. If, however, the failure to file is due to intentional disregard of the filing requirements, the penalty is not less than 10 percent of the aggregate amount not properly reported and the $50,000 limitation will not apply.

Effective Date

This new reporting requirement will apply to amounts received after December 31, 1983.

3. Tax Court Small Tax Case Provision (sec. 123 of the bill and sec. 7463 of the Code)

Present Law

Under present law, taxpayers using the "small tax case" procedure may appear pro se or be represented by any person admitted

to practice before the Tax Court. In general, small tax cases are cases involving $5,000 or less for any one taxable year or period. Such proceedings are generally conducted in a more informal atmosphere, and the Court's opinion is final and may not be appealed.

Reasons for Change

The committee believes that Tax Court cases could be handled more expeditiously if the dollar limit on the cases in which the taxpayer may elect the small tax case procedures were raised.

Explanation of Provision

The bill raises the dollar limit in small tax cases to $10,000.

Effective Date

The provision will be effective on the day after enactment of the bill.

4. Interest Rate on Tax-Shelter Syndicate Items (sec. 124 of the bill and sec. 6621 of the Code)

Present law

Under present law, if a tax is not paid on or before the last date prescribed for payment, interest must be paid by the taxpayer on the unpaid amount for the period from the last date prescribed for payment to the date of payment at an annual rate established under section 6621. In general, the last date prescribed for payment is the due date of the return determined without regard to any extension of time for payment and without regard to any notice and demand for payment issued by reason of a jeopardy assessment (but not later than the date notice and demand for the tax is made by the Secretary).

Under present law, interest is paid by the United States on the overpayment of any tax at the annual rate established under section 6621. Generally, interest is paid with respect to a credit from the date of overpayment (generally the due date of the return) to the due date of the amount against which the credit is taken. In the case of a refund, interest is generally paid from the date of overpayment to the date (to be determined by the Secretary) preceding the date of the refund check by not more than 30 days. However, if the credit or refund is claimed in a late return, no interest is allowed or paid for the period before the date the return is filed. No interest is allowed on an overpayment of income tax if such overpayment is refunded within 45 days after the last date prescribed for filing the return of such tax (without regard to any filing extensions) or, if later, within 45 days after the date the return is filed.

Both the taxpayer and the United States must pay interest compounded at the annual rate established under section 6621. Under present law, interest rates are redetermined twice a year on the basis of the average adjusted prime rate charged by commercial banks during the six-month period ending September 30 (effective

January 1 of the succeeding calendar year), and March 31 (effective July 1 of the same calendar year). Currently, the annual rate is set at 11 percent.

Reasons for Change

The committee is concerned by the continued rise in the backlog of cases with respect to pre-1983 years which involve tax shelter issues. The number of tax shelter cases in examination at the Internal Revenue Service was 195,000 at the end of fiscal year 1980, 250,000 at the end of 1981, and 285,000 at the end of 1982. Over the same period, the backlog of pending cases in the Tax Court increased from 34,776 to 53,440.

Explanation of Provision

Under the bill, the otherwise applicable interest rate for periods after 1983 will be increased by 50 percent tax-shelter items arising with respect to any year. Thus, under the bill a taxpayer who invests in a transaction motivated by a desire to evade or avoid Federal income taxes will have to pay a higher rate of interest if he is found to have underpaid his tax but will be entitled to larger interest payments from the United States if he overpays his taxes and later obtains a refund.

A tax-shelter item is any item giving rise to a deficiency or overpayment if the item arises in connection with any partnership or other entity, any investment plan or arrangement or any other plan or arrangement, if the principal purpose of the partnership, plan, or arrangement is the avoidance or evasion of Federal income tax and more than 34 persons participate in the plan or an arrangement, etc.

To determine the amount of any deficiency or overpayment attributable to a tax-shelter syndicate item, it will be necessary to compare the deficiency or overpayment as finally determined to the deficiency or overpayment that would have existed if the taxpayer's treatment of the items had been determined to be correct. The difference is the overpayment or deficiency attributable to the tax-shelter syndicate items.

Effective Date

The amendment applies to interest with respect to periods after 1983.

5. Reporting on Discharge of Indebtedness (sec. 125 of the bill and new sec. 6050I of the Code)

Present Law

The acquisition by a creditor of property which served as security for a loan may be a taxable event to both the lender and the borrower. The tax effects vary depending upon whether the loan is thereby discharged in whole or in part, whether the debt was recourse or nonrecourse, whether the acquisition was by way of a foreclosure sale or abandonment, *etc.*

In general, foreclosure events are treated as sales or exchanges between the parties to the extent of the fair market value in the case of recourse debt, and to the extent of the debt in the case of nonrecourse debt. In addition, the foreclosure or other acquisition by a lender of property which was security for a loan in full or part satisfaction of the loan, or the abandonment of the property, may (in certain cases), give rise to discharge of indebtedness income to the borrower.

Special rules apply with respect to foreclosures, or other acquisitions of security, by thrift institutions and certain reacquisitions by sellers of real property when the seller took back a purchase money obligation.

Reasons for Change

Under present law, there is no reporting requirement designed to encourage consistent treatment by the lender and the borrower on a foreclosure, or to encourage the correct treatment of discharge of indebtedness income in recourse debt cases. Thus, gain on foreclosure events and discharge of indebtedness income may go unreported. In addition, these events are difficult to detect on audit.

Explanation of Provision

Under the bill, any person (including the United States, a State or any agency or instrumentality of either) who, in connection with a trade or business, lends money secured by property, must report to the Secretary any foreclosure or other acquisition of property in full or partial satisfaction of a debt secured by that property. In addition, the lender must report the abandonment by the borrower of any property which is security for a loan by the lender when the property is first determined to have been abandoned.

In addition, a second reporting requirement arises whenever the lender claims a bad debt deduction or an addition to a bad debt reserve with respect to all or a portion of any debt secured by property. These reports must include the name, address, and taxpayer identification number of the borrower, the original amount of the debt, the type of security for the debt, the method of reacquisition, the amount charged to a reserve (or charged off), the recourse or nonrecourse character of the debt and such other information as the Secretary may prescribe. In each case, a duplicate report must be provided to the debtor by January 31 of the year following the year of the reportable event.

The penalty for failure to make required reports will be similar to that imposed on failures to make other information reports. Thus, the penalty will be $50 per failure, subject to a maximum of $50,000 for any calendar year. The penalty is not applicable if the failure is due to reasonable cause and not to willful neglect. If, however, the failure to file is due to intentional disregard of the filing requirements, the penalty is not less than 10 percent of the aggregate amount not properly reported and the $50,000 limitation will not apply.

Effective Date

This reporting requirement applies with respect to acquisitions, abandonments, or deductions after December 31, 1983.

6. Penalty for Promoting Abusive Tax Shelters (sec. 126 of the bill and sec. 6700 of the Code)

Present Law

Any person who organizes, assists in the organization of, or participates in the sale of any interest in a partnership or other entity, any investment plan or arrangement, or any other plan or arrangement and who makes or furnishes (in connection with such organization or sale), (1) a statement with respect to the allowability of any tax benefit by reason of participating in the entity, plan or arrangement which the person knows or has reason to know is false or fraudulent as to any material matter, or (2) a gross valuation overstatement with respect to any matter material to the entity, plan or arrangement (whether or not the accuracy of the statement of valuation is disclaimed) is subject to a civil penalty. Thus, persons subject to the penalty may include not only the promoter of a tax shelter partnership but also any other person who organizes or sells a plan or arrangement with respect to which there are material misrepresentations or valuation errors affecting the tax benefits to be derived from participation in the arrangement.

A matter is material to the arrangement if it would have a substantial impact on the decision-making process of a reasonably prudent investor. A gross valuation overstatement is any statement or representation of the value of services or property which exceeds 200 percent of the correct value of the property or services and which is directly related to the amount of any income tax deduction or credit allowable to any participant.

The penalty for promoting an abusive tax shelter is an assessable penalty equal to the greater of $1,000 or 10 percent of the gross income derived, or to be derived, from the activity. There need not be reliance by the purchasing taxpayer or actual underreporting of tax.

The Secretary is given authority to waive all or part of any penalty resulting from a gross valuation overstatement, upon a showing that there was a reasonable basis for the valuation and the valuation was made in good faith.

Reasons for Change

The attention of the committee has been drawn to evidence that the $1,000 or 10-percent penalty enacted in TEFRA is inadequate in amount since promoters of tax shelters operate on a large margin.

Explanation of Provision

The bill increases the penalty for promoting abusive tax shelters to the greater of $2,000 or 20 percent of the gross income derived, or to be derived, from the activity.

Effective Date

The amendments to the promoter penalty will take effect on the date of enactment.

7. Changes in Accounting Method (sec. 128 of the bill and sec. 446 of the Code)

Present Law

Under present law, a taxpayer is not permitted to change its method of accounting without the consent of the Secretary. Some taxpayers who are using improper methods of accounting have argued that there is no requirement that they request permission to change from the improper to a proper method of accounting. Thus, they assert the failure of the Secretary to consent to a change in method as a defense to, for example, the negligence penalty.

Reasons for Change

The committee believes that the interpretation placed on present law by taxpayers with improper methods of accounting may create an unintended protection against penalties for taxpayers.

Explanation of Provision

The bill provides that a failure to file a request of the Secretary to change a method of accounting will bar the taxpayer from asserting as a defense to any penalty under the Code the fact that a change from the method of accounting was not permitted because the Secretary had not given his consent. Thus, a taxpayer using an improper method of accounting cannot assert that such conduct was not negligent because permission had not been granted to change to a permissible method.

Effective Date

The amendments relating to changes in accounting method will apply in taxable years beginning after the date of enactment. The committee does not intend that any inference be drawn with respect to the validity of the defense asserted by some taxpayers under present law.

8. Regulation of Appraisers Practicing Before the Internal Revenue Service (sec. 127 of the bill and new sec. 330 of Title 31)

Present Law

Under present law, the Secretary of the Treasury may prescribe rules governing the admission of lawyers and accountants to practice before the Internal Revenue Service and may bar individuals from practice if he finds them to be incompetent, disreputable or grossly negligent. Present law does not provide any comparable authority with respect to the appearance of professional appraisers in proceedings at the Internal Revenue Service.

Reasons for Change

The committee believes that professional appraisers who seek to present evidence to the Internal Revenue Service should be subject to the same type of professional regulation that applies to attorneys and accountants practicing before the Internal Revenue Service and to attorneys appearing in court proceedings.

Explanation of Provision

Under the bill, the Secretary of the Treasury is authorized to bar from appearing before the Internal Revenue Service for the purpose of offering opinion evidence on the value of property or an interest in property, any individual who has violated the provisions of section 6701 of the Internal Revenue Code. Thus, an appraiser who aids or assists in the preparation or presentation of an appraisal in connection with the tax laws will be subject to disciplinary action if the appraiser knows that the appraisal will be used in connection with the tax laws and will result in an understatement of the tax liability of another person if so used.

Effective Date

The provision will apply upon enactment.

9. Revenue Effects of Compliance Provisions

The compliance provisions will increase fiscal year budget receipts by $33 million in 1984, $92 million in 1985, $170 million in 1986, $211 million in 1987, and $232 million in 1988.

H. Withholding on Dispositions by Foreigners of United States Real Property Interests (sec. 116 of the bill and sec. 6039C and new sec. 1444 of the Code)

Present Law

In 1980, the Congress adopted the Foreign Investment in Real Property Tax Act, requiring that foreign persons who dispose of U.S. real property interests pay tax on any gain realized on the disposition. The interests on whose disposition recognition occurs include real estate and shares in certain corporations owning primarily real estate. The intent of the legislation was to treat foreign investors the same as U.S. persons by removing certain preferential tax treatment previously accorded them.

The Act provides for enforcement of the tax on foreigners through a system of information reporting designed to identify foreign owners (rather than sellers) of U.S. real property interests.

Reasons for Change

A major problem with the Foreign Investment in Real Property Tax Act is that it can often be easily evaded. Since the tax is not due until a tax return is filed after the end of the year, a foreign person can sell his U.S. real estate, take the proceeds out of the United States and, since he is beyond the jurisdiction of the United States, not pay any tax to the United States on the sale. Moreover, through nominees and foreign corporations established in tax havens, he can reinvest these untaxed proceeds back in the United States with impunity.

The Senate version of the 1980 legislation sought to deal with this problem by requiring that the purchaser of the U.S. real estate or other persons with control over the amount paid withhold the tax that would be due on the sale. This is the method used to insure collection of tax on other payments of income to foreign persons, and is used by almost all countries.

The conference on the 1980 legislation dropped the withholding provision. The conferees were concerned about protecting withholding agents who might not know that a seller is a foreign person. The conferees agreed that it would be necessary to structure withholding provisions carefully to insure that they would not inadvertently disrupt the U.S. real estate market or expose U.S. buyers or U.S. agents of foreign sellers of U.S. real estate to liability where such liability is not appropriate. The Senate voted again in 1981 and 1982 to impose withholding on sales of U.S. real property to foreigners, but in each case the conference committee failed to agree to withholding.

In lieu of withholding, the provisions of the Foreign Investment in Real Property Tax Act are currently to be enforced through in-

formation reporting. The Act requires the Secretary of the Treasury to issue regulations providing for reporting. However, the Treasury has had difficulty in developing such regulations; it has not yet issued final regulations to require information reporting, so none is now required.

Enforcement through withholding has several advantages over enforcement through information reporting. Most importantly, withholding should prove more effective than information reporting, and will eliminate the problem of identifying owners of bearer shares. It will also relieve U.S. persons of significant paperwork because the bill authorizes the Treasury to relax or eliminate the information reporting requirements. In addition, the relaxation or elimination of information reporting could reassure legitimate foreign investors who may fear disclosure of their holdings to their potential political adversaries in their home countries.

Explanation of Provision

The bill requires withholding by a transferee of U.S. real estate, any agent of a transferee, or any settlement officer or transferor's agent (hereinafter collectively referred to as "withholding agent") where a U.S. real property interest is acquired from a foreign person.

Withholding rate

The amount to be withheld is the smallest of: first, in the case of a corporate transferor, 28 percent of the sales price, or in the case of a noncorporate transferor, 20 percent of the sales price; second, the transferor's maximum tax liability, discussed below; or third, the fair market value of that portion of the sale proceeds which is within the withholding agent's control. In determining the amount within the withholding agent's control, the withholding agent may be deemed to control certain debts within two years of the transfer for which the transferee or the property is liable. This last rule, designed to prevent mortgaging out of gain, is to be subject to such exceptions as the Secretary may provide by regulations.

The transferor's maximum tax liability consists of two elements: first, the maximum amount that the Treasury (upon request of the transferor or the withholding agent) determines that the transferor could owe on his gain on the sale, discussed below, and second, any unsatisfied prior withholding tax liabilities caused by prior foreign ownership with respect to the transferred property that, under the bill, were previously required to be withheld but were not withheld. The first element, the maximum tax that the transferor could owe on the sale, is to be calculated on a transaction by transaction basis at the highest possible tax rate for that transaction. For example, if a nonresident alien purchased unimproved land on January 1, 1983 for $100,000, and sold the land on September 1, 1984, for $110,000, his maximum tax liability for that sale would be $2,000, i.e., 20 percent, the highest marginal tax rate for long-term capital gains of an individual, times $10,000, his net gain. Neither offsetting transactions (completed or anticipated) nor the presumed absence of other income during the taxable year would enter into

the calculation of the maximum tax that the transferor could owe on the sale.

Withholding agent

While the bill generally places an obligation to withhold when a U.S. real property interest is acquired from a foreign person, the withholding requirement applies to a transferee, a transferee's agent, or a settlement officer only if he knows or has received notice from either the transferor or any agent of the transferor that the transferor is a foreign person. The transferor is required to notify the transferee, the transferee's agent, and the settlement officer that the transferor is a foreign person. A transferor's agent is also required to notify the transferee that the transferor may be a foreign person if the agent has reason to believe that the transferor may be a foreign person. If the transferor's agent fails to make a reasonable inquiry about the transferor's status, he is required to notify the transferee that the transferor may be foreign. However, the transferor's agent is relieved of any responsibility to give notice to a transferee if he relies in good faith on a written statement of the transferor—or, in the case of a transferor's agent retained by another agent of the transferor a written statement by that other agent of the transferor—that the transferor is a U.S. person. A transferor's agent who does not carry out his obligation to provide notice is required to withhold the appropriate amount from any of the transferee's consideration he has within his control, including any compensation received by him in connection with the transaction.

The bill defines transferor's agent as a person who actually represents a foreign transferor in negotiations preceding the transaction or at settlement of the transaction. The definition also includes a person who, in negotiations or at settlement, represents the transferor indirectly through a subagency relationship. A person who, at the transferor's request, procures the services of an agent for negotiations or settlement, is also an agent of the transferor. The bill specifies certain actions that a person might take, even on behalf of the transferor, without automatically coming within the definition of an agent of the transferor. Receipt or disbursement of any of the consideration for the transaction (for instance, by an escrow agent) does not automatically cause agency status; neither does recording of documents involved in the transaction.

Exemptions from withholding

The bill provides for exemptions from withholding in three cases. First, withholding is not required if the transferee is to use the real property as his principal residence and the purchase price is $200,000 or less. Second, withholding is not required if the transferor obtains a qualifying statement from the Treasury that he is exempt from tax or has provided adequate security for payment of the tax, or has otherwise made arrangements with Treasury for the payment of the tax. Third, withholding is not required if the property being transferred is stock of a corporation and the transfer takes place on an established U.S. securities market.

Miscellaneous

Provision is made for the Treasury, upon request of the transferor or any withholding agent, to reduce the amount of withholding otherwise required. Any such request, as well as a request for a qualifying statement, must be acted upon within 30 days of receipt of the request.

The bill provides special rules for withholding by a domestic partnership, a trustee of a domestic trust, or an executor of a domestic estate. These persons are required (pursuant to such terms and conditions as regulations may require) to withhold from amounts which such entities have in their custody and which are attributable to the disposition of a U.S. real property interest, but only if the amounts are income of a nonresident alien individual or foreign corporation, partnership, trust, or estate.

Withholding is also required where a U.S. real property interest is distributed by a foreign corporation or is disposed of in certain transactions on which gain is recognized under the U.S. real property rules but that, under the Code's general rules, would be nonrecognition transactions. For example, when a liquidating foreign corporation distributes a U.S. real property interest to its shareholders, it is required to withhold a tax equal to 28 percent of the fair market value of the property reduced by the adjusted basis of the property.

Effective Date

The withholding requirements of this provision apply to payments of consideration with respect to the acquisition of a United States real property interest that are made more than 30 days after the date of the bill's enactment.

Revenue Effect

This provision will increase fiscal year budget receipts by $73 million in 1984, $7 million in 1985, $8 million in 1986, $9 million in 1987, and $9 million in 1988.

V. EXPLANATION OF SPENDING REDUCTION PROVISIONS

A. Medicare and Medicaid and Other Health Provisions

1. Extension of Limitations on Part B Premium Increases (sec. 151 of the bill)

Present Law

By law, the Secretary of Health and Human Services has been required to calculate each December the increase in premiums of those who elect to enroll in the Supplementary Medical Insurance (or Part B) portion of the Medicare program. The new premium rates have been effective on July 1 of the year following the year in which the calculation was made. Ordinarily, the new premium rate is the lower of: (1) an amount sufficient to cover one-half of the costs of the program for the aged or (2) the current premium amount increased by the percentage by which cash benefits increased under the cost-of-living adjustment (COLA) provisions of the social security programs. Premium income, which originally financed half of the costs of Part B, had declined—as the result of this formula—to less than 25 percent of total program cost. The "Tax Equity and Fiscal Responsibility Act of 1982" (TEFRA) temporarily suspended the COLA limitation for two one-year periods, beginning on July 1, 1983. During these periods, enrollee premiums would be allowed to increase to amounts necessary to produce premium income equal to 25 percent of program costs for elderly enrollees. The limitation would again apply with respect to periods beginning July 1, 1985 and thereafter.

The "Social Security Amendments of 1983" (Public Law 98–21) postponed the scheduled July 1, 1983 increase to January 1, 1984 to coincide with the delay in the cost-of-living increase in social security cash benefit payments. Future increases will occur in January of each year based on calculations made the previous September. Public Law 98–21 further provided that the suspension of limitations as authorized by TEFRA is to apply for the two-year period beginning January 1, 1984, and ending December 31, 1985.

Explanation of Provision

The amendment extends for one year the existing temporary provision which fixes the proportion of the Part B Medicare costs financed by enrollees at 25 percent of program costs.

Effective Date

Enactment.

Estimated Savings

Fiscal years:	*Millions*
1984	.....
1985	.....
1986	$359
3-year total	359

2. Limitation on Physician Prevailing Charge Levels (sec. 152 of the bill)

Present Law

Under current law, Medicare pays for physician services on the basis of Medicare-determined "reasonable charges." "Reasonable charges" are the lesser of: a physician's actual charges, the customary charges made by an individual physician for specific services, or the prevailing level of charges made by other physicians for specific services in a geographic area. The amounts recognized by Medicare as customary and prevailing charges are updated annually (on July 1) to reflect changes in physician charging practices. Increases in prevailing charge levels are limited by an economic index which reflects changes in the operating expenses of physicians and in general earnings levels. The economic index limit promulgated for the period July 1, 1983 through June 30, 1984 represents an increase of 5.85 percent over the index utilized for the previous 12-month period.

Explanation of Provision

The amendment provides that the prevailing charge level which was in effect prior to the annual updating which occurred on July 1, 1983 would be utilized for the December 1, 1983–June 30, 1984 period. Thus, for this seven month period until July 1, 1984, prevailing limits for all physician services would revert to the levels applicable during the July 1, 1982–June 30, 1983 fee screen year. Physicians' current customary charge screens would not be affected by the rollback.

Effective Date

December 1, 1983.

Estimated Savings

Fiscal years:	*Millions*
1984	$320
1985	630
1986	740
3-year total	$1,690

3. Hepatitis B Vaccine (sec. 153 of the bill)

Present Law

Present law precludes Medicare coverage of immunizations and vaccines with the exception of pneumococcal vaccines. Therefore, the program does not cover immunizations against viral hepatitis, an infectious disease that produces acute and chronic inflamation of the liver which may lead to serious illness or death.

End stage renal disease (ESRD) patients are currently monitored by monthly testing for the virus, and these tests are covered and paid for under Medicare.

Explanation of Provision

The amendment covers Hepatitis B vaccine under Medicare for ESRD hemodialysis patients.

The committee has given the Secretary the flexibility to develop a payment method that may be different from the usual medicare reimbursement rules. In developing such a payment system, the committee believes that any payment system should provide a payment amount which reasonably reflects the cost of efficiently providing and administering the vaccine.

Effective Date

October 1, 1983.

Estimated Savings

Fiscal years:	*Millions*
1984	$+2
1985	1
1986	2
3-year total	1

4. Limitation on Certain Foot Care Services (sec. 154 of the bill)

Present Law

Routine foot care is not covered under the Medicare program; however, Medicare does allow reimbursement to physicians for debridement of mycotic toenails (toenails with fungal infection) which should not be performed by a nonprofessional.

There has been considerable concern regarding the frequency with which this procedure is taking place. The Health and Human Services Inspector General conducted a review in Virginia and concluded that this benefit was being abused because the procedure was being performed more frequently than necessary and was being performed on patients (particularly nursing home patients) who did not require professional care.

Explanation of Provision

The amendment would require the Secretary to issue regulations establishing coverage guidelines under the Medicare program for debridement of mycotic toenails. Unless the Secretary determines

otherwise, no payment would be made for such services where performed more frequently than once every 60 days. Exceptions could be authorized if medical necessity were documented by the physician.

Effective Date

Services furnished on or after January 1, 1984.

Estimated Savings

Fiscal years:	*Millions*
1984	$28
1985	40
1986	42
3-year total	$110

5. Coverage of Hemophilia Clotting Factor (sec. 155 of the bill)

Present Law

Present law excludes coverage of drugs and biologicals unless they are of the type that cannot be self-administered and are commonly furnished incident to physicians services.

Hemophilia is a life-long disease in which a patient whose blood lacks a clotting factor is subject to spontaneous hemorrhages. In the past 13 years hemophilia patients have had the benefit of a human blood derived concentrate which, when infused, stops hemorrhaging, and when appropriately given in advance may prevent bleeding.

The hemophilia clotting factor is considered to be a biological under Medicare and is covered when provided by a physician to a patient, on either an inpatient or outpatient basis.

Explanation of Provision

The amendment would permit Medicare coverage for the supplies and products necessary for the self-administration of the clotting factor, subject to utilization controls deemed necessary by the secretary for the efficient use of the factors.

Effective Date

Items and services administered on or after enactment.

Estimated Savings

Fiscal years:	*Million*
1984	negligible
1985	negligible
1986	negligible
3-year total	negligible

6. Fee Schedule for Clinical Laboratory Services (sec. 156 of the bill)

Present Law

Under current law, outpatient diagnostic laboratory services are reimbursed on the basis of reasonable charges when furnished by an independent laboratory or by a physician. Payment for such services to hospital outpatients is on the basis of reasonable cost. These laboratory services are covered under part B of the Medicare program; thus, the beneficiary is subject to the part B deductible and coinsurance requirements.

Explanation of Provision

The amendment would require the establishment of a fee schedule for all laboratory services except those for hospital-based laboratory service. Payments would be based on the fee schedule unless the actual charge is lower. The schedule would be established on a carrier basis for two years.

The initial payment level for the fee schedule would be established at 65% of prevailing charges for the fee screen year beginning July 1, 1983. The Secretary would be required to adjust the fee schedules annually to reflect changes in the Consumer Price Index for all Urban Consumers (U.S. city average).

All clinical laboratories would be required to bill the medicare program or beneficiaries directly, rather than billing the physician who ordered the tests (laboratories performing tests "under arrangement" with a hospital could continue to bill the hospital for hospital outpatients). Physicians would be permitted to bill for clinical laboratory services only when the physician directly provides, or supervises the provision of, clinical laboratory services.

The committee amendment would provide that acceptance of assignment for the performance of laboratory services is optional for both clinical laboratories and physicians. Where either accepts assignment, reimbursement would be made at 100% of the fee schedule amount (or, if lower, the billed charge), with the deductible and coinsurance waived.

Laboratories and physicians not accepting assignment would continue to be reimbursed at 80 percent of the fee schedule amount or if lower, 80 percent of the billed charge; applicable deductible and coinsurance amounts would continue to apply.

The amendment would direct the Secretary to simplify current billing requirements for laboratory services. The required data must however be sufficient to counter potential fraudulent or abusive practices.

The amendment further requires the Secretary to report to the Congress by June 1985 on the appropriate treatment of hospital-based laboratories, direct payment of all lab fees to physicians, the basis for the formulation of a nationwide fee schedule, and an appropriate indexing mechanism for such a schedule.

Effective Date

Diagnostic laboratory tests furnished on or after March 1, 1984, and before March 1, 1986.

Estimated Savings

Fiscal years:	*Millions*
1984	$75
1985	175
1986	70
3-year total	320

7. Index Part B Deductible (sec. 157 of the bill)

Present Law

Under present law, enrollees in the Supplementary Medical Insurance (or Part B) portion of Medicare must pay the first $75 of covered expenses (known as the deductible) each year before any benefits are paid. The amount of this deductible is fixed by law.

Explanation of Provision

The amendment would index the amount of the part B deductible for 3 years beginning in calendar year 1984, by the percentage by which the Medicare economic index increases each year. The Medicare economic index is the index used to limit increases in the prevailing level of physician fees reimbursable under the Part B program. It is estimated that the deductible would increase to $80 in calendar year 1984, $85 in calendar year 1985, and $90 in calendar year 1986, and then remain at that level.

Effective Date

January 1, 1984.

Estimated Savings

Fiscal years:	*Millions*
1984	$50
1985	115
1986	180
3-year total	345

8. Reduce Reimbursement to Home Health Agencies for Durable Medical Equipment (sec. 158 of the bill)

Present Law

Under present law, when covered durable medical equipment (DME) is furnished by a supplier of services, rather than by an institutional provider, payment is made under the Part B program

on the basis of 80 percent of the reasonable charges (after the deductible is satisfied). If the equipment is furnished by a provider, such as a home health agency, payment is made on the basis of 100 percent of the reasonable cost of the rental or purchase of such equipment.

Explanation of Provision

The amendment would reimburse home health agencies for durable medical equipment at 80 percent of reasonable cost and permit the agencies to bill beneficiaries for the remaining 20 percent.

Effective Date

Items or services furnished on or after enactment.

Estimated Savings

Fiscal year	*Millions*
1984	$10
1985	20
1986	20
3-year total	50

9. Increase Medicaid Ceilings for Puerto Rico and the Territories (sec. 159 of the bill)

Present Law.

Current law authorizes participation of Puerto Rico, the Virgin Islands, Guam, the Northern Mariana Islands, and American Samoa in the Medicaid programs. It sets the Federal matching rate for these jurisdictions at 50% and authorizes annual ceilings on such payments of $45 million for Puerto Rico, $1.5 million for the Virgin Islands, $1.4 million for Guam, $350,000 for the Northern Mariana Islands, and $750,000 for American Samoa.

Explanation of Provision

The Committee amendment would raise the annual dollar ceilings on Federal payments to these jurisdictions. The new ceilings would be $63.4 million for Puerto Rico, $2.1 million for the Virgin Islands, $2.0 million for Guam, $550,000 for the Northern Mariana Islands, and $1,150,000 for American Samoa.

Effective Date

October 1, 1983.

Estimated Cost

Fiscal years:	*Millions*
1984	$20
1985	20
1986	20
3-year total	60

10. Increase Authorization for Maternal and Child Health Block Grant Program (sec. 160 of the bill)

Present Law

The present law authorizes $373 million for the Maternal and Child Health (MCH) Block grant program. Congress appropriated an additional $105 million for the program in fiscal year 1983 under Public Law 98–8.

Explanation of Provision

The amendment would permanently increase the authorization level for the MCH block grant program. The level would be increased to $452 million in fiscal year 1984, $453 million in fiscal year 1985, and $455 million in fiscal year 1986 and thereafter.

Effective Date

October 1, 1983.

Estimated Cost

Fiscal years:	*Millions*
1984	$55
1985	64
1986	42
3-year total	$183

11. Medicaid Coverage for Pregnant Women (sec. 161 of the bill)

Present Law

Prior to the enactment of the "Omnibus Budget Reconciliation Act of 1981" (Public Law 97–35) States were permitted to make AFDC payments to pregnant women on the basis of their unborn children. Pregnant women who are entitled to AFDC cash payments on this basis were also entitled to Medicaid coverage. Public Law 97–35 prohibited States from making AFDC cash payments to a pregnant woman on the basis of her unborn child until the sixth month of pregnancy. However, States are permitted to extend Medicaid eligibility to these women from the time the pregnancy has been medically verified. An estimated 80 percent of the States and jurisdictions have elected to provide coverage to a pregnant woman on the basis of her unborn child for either all or a portion of her pregnancy.

Explanation of Provision

The amendment would mandate States to provide Medicaid coverage beginning with the medical determination of pregnancy to every woman who would be eligible for AFDC if the child were born.

Effective Date

January 1, 1984. A later implementation date is permitted where State legislation is required.

Estimated Costs

Fiscal years:	*Millions*
1984	$6
1985	11
1986	12
3-year total	$29

12. Delay of Effective Date for Single-Rate for Skilled Nursing Facilities (sec. 162 of bill)

Present Law

The Tax Equity and Fiscal Responsibility Act of 1982 (P.L. 97-248) required the Secretary to establish a single payment limit for both free-standing and hospital-based skilled nursing facilities (SNFs), effective October 1, 1982.

In the Social Security Amendments of 1983 (P.L. 98-21), the effective date was postponed for one year. In addition, the Congress required the Secretary to report by December 31, 1983 on the effect of the implementation of the TEFRA single-rate provision on hospital-based SNFs, given the difference (if any) in the patient populations served by such facilities and by freestanding SNFs. Further, the Secretary was required to report by the end of 1983 on the impact of hospital prospective payment on SNFs.

Explanation of Provision

The amendment postpones implementation of the single rate for SNFs until April 1, 1984. The committee believes it prudent to wait until the Secretary has completed her report on hospital-based SNFs before implementing the single-rate provision.

Effective Date

Enactment.

Estimated cost

Fiscal years:	*Millions*
1984	$10
1985	20
1986	0
3-year total	30

13. Recertification of SNF/ICF Patients (sec. 163 of the bill)

a. Present Law

Under current Medicaid law, a State's evidence of a satisfactory program of controls over utilization must include evidence that physicians recertify the need for continuing skilled nursing facility

(SNF) and intermediate care facility (ICF) services every 60 days. There is evidence that less frequent recertification may be more appropriate in the case of long term intermediate care facility stays.

Explanation of Provisions

The amendment would modify the current physician recertification schedule. For skilled nursing facilities the following schedule would be established:

30 days after initial admittance;
60 days after initial admittance;
90 days after initial admittance;
60-day intervals thereafter.

For intermediate care facilities, the following schedule would be established:

60 days after initial admittance;
120 days after initial admittance;
12 months after initial admittance;
18 months after initial admittance;
24 months after initial admittance;
1-year intervals thereafter.

b. Present Law

Current law requires 100 percent on-time compliance with physician recertification requirements.

Explanation of Provisions

The amendment permits a ten day grace period if a state demonstrates good cause for physicians not meeting the deadline.

c. Present Law

By law, the quarterly Federal penalty imposed on States for failure to have an adequate program of controls over utilization is equal to 33⅓ percent multiplied by a ratio of all medicaid patients in facilities with one or more surveyed records out of compliance to all medicaid patients in surveyed facilities.

Explanation of Provisions

The amendment would modify the existing formula by substituting 5 percent for the existing 33⅓ percent figure. Further, the amendment would specify that no penalty would be imposed in cases where the error rate was less than three percent.

Effective Date

Quarters beginning on or after enactment.

Estimated Savings

	Millions	
	Medicare	Medicaid
Fiscal years:		
1984	$25	$8
1985	27	1
1986	29	.....
3-year total	81	9

14. Study on Payments for Physicians Cognitive Skills (Sec. 164 of the bill)

Present Law

Medicare payments to physicians are made on the basis of reasonable charges for specific services. There is concern that the existing payment methodology may result in payment imbalances between various physician specialties, types of procedures, and health care settings. The current reimbursement system rewards physicians for their technical skills and for the performance of certain activities such as surgery or diagnostic tests. As a result, there is concern that the system discourages physicians from spending time with patients to counsel or examine them.

Explanation of Provision

The amendment directs the Office of Technology Assessment in consultation with appropriate physician organizations to conduct a study examining any imbalance in payments to physicians for their cognitive vs. their technical services. It is the hope of the Committee that the OTA study results include specific recommendations on ways to modify the existing system for determining Medicare allowances to eliminate any inequities that exist between reimbursement levels for medical procedures and cognitive services.

OTA is also directed to include specific findings and recommendations on: creating a means to adjust allowances to physicians as the costs and risks to physicians, which result from new technologies and procedures, decrease over time. The amendment requires submission of the report to Congress by December 31, 1985.

Effective Date

Enactment.

15. Elimination of Part B Deductible for Certain Diagnostic Laboratory Tests (sec. 165 of the bill)

Present Law

Present law authorizes the Secretary to negotiate with a laboratory a payment rate that is considered the full charge for diagnostic tests. The payment, which is made directly to the laboratory, equals 100 percent of the negotiated rate subject to the annual Part B deductible. The beneficiary is not liable for coinsurance payments.

Explanation of Provision

The amendment eliminates application of the annual part B deductible in the case of diagnostic tests performed in a laboratory which has entered into a negotiated rate agreement with the Secretary. Should the fee schedule provision by the Committee not be extended beyond March 1, 1986 this provision would then provide an incentive for laboratories to enter into such agreements and thereby reduce costs associated with individual billing of Medicare beneficiaries.

Effective Date

Diagnostic tests performed on or after March 1, 1986.

16. Payment for Services Following Termination of Participation Agreements With Home Health Agencies and Hospices (sec. 166 of the bill)

Present Law

Under current law, if Medicare participation of a home health agency or a hospice is terminated, the Secretary is required to continue to pay for services provided to a beneficiary until the end of the calendar year in which the termination took place. This requirement is only applicable to services provided under an individual plan of care established prior to the termination of the agency.

Explanation of Provision

The amendment changes from the end of the calendar year to 30 days after termination, the ending of coverage for services provided under a plan established prior to the termination date of the participation agreement. This amendment brings provisions for home health agencies and hospices into conformity with provisions for hospitals and skilled nursing facilities.

Effective Date

Enactment.

17. Repeal of Special Tuberculosis Treatment Requirements Under Medicare and Medicaid (sec.167 of the bill)

Present Law

Present law contains a number of provisions intended to assure that institutional services provided to Medicare and Medicaid patients suffering from tuberculosis are not custodial in nature and that such treatment can reasonably be expected to improve the patient's condition or render the condition noncommunicable.

Explanation of Provision

The amendment repeals the special provisions. Advances in the active treatment of tuberculosis make such safeguards against paying for custodial care for tuberculosis patients unnecessary. The amendment also eliminates the special provider category in present law for tuberculosis hospitals in the Medicare and Medicaid programs.

Effective Date

Enactment.

18. Medicare Recovery Against Certain Third Parties (sec. 168 of the bill)

Present Law

Under current law, the Medicare program may make payments for services for which other third party insurance programs (e.g., worker's compensation, auto or liability insurance, and employer health plans) are ultimately liable for some or all of the costs. However, the Secretary does not now have the right of subrogation to become a party to claims against other liable parties or to recover directly from such parties.

Explanation of Provision

The amendment establishes the statutory right of Medicare to recover directly from a liable third party, if the beneficiary himself does not do so, and to pay a beneficiary, or a third party on the beneficiary's behalf, pending recovery where such third party is not expected to pay promptly. The amendment would provide that the United States shall be subrogated to any the right of the individual or anyone else to payment from the third party. These provisions are intended to improve the ability of the Medicare program to obtain reimbursement to which it is entitled by law.

Effective Date

Enactment.

19. Indirect Payment of Supplementary Medical Insurance Benefits (sec. 169 of the bill)

Present Law

Current law does not, in general, permit Medicare Part B payments to be made to anyone other than a beneficiary or an entity providing services.

Explanation of Provision

The amendment permits Part B payments to be made to a health benefits plan whose payment is accepted by the physician or other supplier as payment in full. The purpose of this provision is to enable this indirect payment procedure to be available to group as well as non-group, employment and non-employment health benefit plans such as employers, unions, insurance companies, and other organizations.

Effective Date

Enactment.

20. Elimination of Health Insurance Benefits Advisory Council (sec. 170 of the bill)

Present Law

Section 1867 of the Social Security Act provides for a 19 member panel of health experts (the Health Benefits Advisory Council or HIBAC) appointed by the Secretary to advise on matters of general policy with respect to the Medicare program.

Explanation of Provision

The amendment repeals Section 1867. HIBAC was very active in the early years of the Medicare program when regulations were first promulgated. As the Federal Government gained experience in administering the Medicare program, the Council's advisory functions with respect to regulations became less important. With passage of the Social Security Amendments of 1972, Public Law 92–603, the Council's authority to review regulations and recommend changes was specifically deleted, and its role limited to advice on matters of "general policy." Also, its purview was extended to include the Medicaid program. However, HIBAC has not been called upon to advise the Secretary since late in 1976, and there are currently no members.

Effective Date

Enactment.

21. Hospital Accreditation Surveys of the American Osteopathic Association Not To Be Disclosed (sec. 171 of the bill)

Present Law

Current law contains certain disclosure safeguards relating to survey information used by the Secretary in connection with the hospital certification process under Medicare. However, the law only specifically refers to surveys conducted by the Joint Commission on the Accreditation of Hospitals (JCAH).

Explanation of Provision

The amendment extends the same disclosure protections given JCAH survey information to similar survey information provided to the Secretary by the American Osteopathic Association or other national accreditation organizations.

Effective Date

Enactment.

22. Flexible Sanctions for Noncompliance With Requirements for End Stage Renal Disease Facilities (sec. 172 of the bill)

Present Law

Current law and regulations provide for decertification of end-stage renal disease (ESRD) facilities that are not in complete compliance with Medicare program requirements.

Explanation of Provision

The amendment allows the Secretary to apply intermediate sanctions, such as a graduated reduction of reimbursement to ESRD facilities, when noncompliance does not jeopardize patient health or safety, or justify decertification of such facilities. Noncompliance would, in these cases, deal primarily with administrative requirements. This amendment makes the treatment of ESRD facilities comparable to the treatment of nursing homes which are out of compliance.

The committee intends that the Secretary in applying the sanctions, should take certain factors into account. When reviewing a facility's compliance with the nurse staffing requirements, consideration should be given to the economic situation of areas with exceedingly high unemployment rates. For example, an area may be unable to recruit nurses because of the difficulty in finding employment for the nurses' spouses. In addition, in the event that a free standing facility functions as a sole community provider for dialysis services, care shall be taken to ensure that Medicare beneficiaries requiring inpatient services continue to have those services available in a reasonably accessible facility.

Effective Date

Enactment.

23. Use of Additional Accrediting Organizations Under Medicare (sec. 173 of the bill)

Present Law

Under current law, the Secretary has authority to rely on certain accrediting organizations in determining whether hospitals, skilled nursing facilities, home health agencies, ambulatory surgical centers and hospice programs meet Medicare requirements.

Explanation of Provision

The amendment extends the Secretary's authority to permit him to rely on such organizations in determining whether rural health clinics, laboratories, clinics, rehabilitation agencies, including outpatient rehabilitation facilities, and public health agencies meet Medicare requirements (and clarify his authority with respect to ambulatory surgical centers). The standards of an accrediting organization chosen must be at least equivalent to those of the Secretary, and it must have a satisfactory record of application of such standards.

Effective Date

Enactment.

24. Repeal of Exclusion of For-Profit Organizations From Research and Demonstration Grants (sec. 174 of the bill)

Present Law

Current law limits the awarding of grants (under sections 1110 of the Social Security Act and section 222(b) of the 1972 Medicare amendments) for the conduct of research and demonstrations to non-profit organizations. However, contracts are permitted to be awarded to both for-profit and not-for-profit organizations.

Explanation of Provision

The amendment extends the research and demonstration grant authority to for-profit organizations as well as non-profit organizations.

Effective Date

Enactment.

25. Requirements for Medical Review and Independent Professional Review Under Medicaid (sec. 175 of the bill)

Present Law

Under current law, medical review requirements for skilled nursing facilities (SNFs) and independent professional review for intermediate care facilities (ICFs) under Medicaid both call for teams of physicians, registered nurses and other appropriate personnel to conduct virtually similar kinds of review.

Explanation of Provision

The amendment makes consistent State plan requirements for medical review and independent professional review thereby clarifying that there is no substantial statutory difference between review of these organizations. The amendment also corrects a technical error in present law to assure that Christian Science sanatoria are excluded from the revised medical review/independent professional review requirements.

Effective Date

Enactment.

26. Flexibility in Setting Payment Rates for Hospitals Furnishing Long-Term Care Services Under Medicaid (sec. 176 of the bill)

Present Law

Current law contains special requirements for the establishment of payment rates for hospitals furnishing skilled nursing or intermediate care facility services under Medicaid.

Explanation of Provision

The amendment deletes the specific requirements for setting payment rates applicable only to hospital furnished long-term care services. Under the amendment such rates must meet the same general criteria as are applicable to rates for similar services provided by long-term care institutions to Medicaid recipients.

Effective Date

Enactment.

27. Authority of Secretary To Issue and Enforce Subpoenas Under Medicaid (sec. 177 of the bill)

Present Law

Current law authorizes the Secretary to issue and seek enforcement of subpoenas under Medicare to obtain information needed in connection with hearings, investigations and other matters related to program fraud and abuse.

Explanation of Provision

The amendment authorizes the Secretary to issue and seek enforcement of subpoenas under Medicaid to the same extent that he has authority under the Medicare program.

Effective Date

Enactment.

28. Repeal of Authority for Payments To Promote Closing and Conversion of Underutilized Hospitals (sec. 178 of the bill)

Present Law

Section 2101 of the "Omnibus Budget Reconciliation Act of 1981" (Public Law 97-35) authorized the Secretary to make Medicare and Medicaid payments to cover capital and increased operating costs associated with the conversion or closing of underutilized hospital facilities. The provision, which has never been implemented, restricts the number of facilities which may receive these funds to no more than 50 prior to January 1, 1984.

Explanation of Provision

The amendment repeals this provision.

Effective Date

Enactment.

29. Presidential Appointment of and Pay Level for the Administrator of the Health Care Financing Administration (sec. 179 of the bill)

Present Law

By law, the Administrator of the Health Care Financing Administration (HCFA) is in the Senior Executive Service and is appointed by the Secretary of Health and Human Services.

Explanation of Provision

The amendment provides for the appointment of the Administrator of HCFA by the President, with the advice and consent of the Senate. The position and pay of the administrator is increased to Level IV of the Executive Schedule.

Effective Date

Applies to appointments to the position made after enactment.

30. Exclusion of Certain Entities Owned or Controlled by Individuals Convicted of Medicare or Medicaid Related Crimes (sec. 180 of the bill)

Present Law

Current law authorizes the Secretary to bar from participation in Medicare (and to direct State agencies to bar from Medicaid) institutional providers in which a significant interest is held by a person convicted of program-related criminal offenses.

Explanation of Provision

The amendment extends the Secretary's authority to also exclude from Medicare participation (and to direct State agencies to exclude from Medicaid participation) any entity or supplier of serv-

ices in which a significant ownership or controlling interest is held by a person convicted of program related criminal offenses.

Effective Date

Enactment.

31. Judicial Review of Provider Reimbursement Review Board Decisions (sec. 181 of the bill)

Present Law

The "Social Security Amendments of 1983" (Public Law 98-21) permits groups of providers to bring action in the judicial district in which the largest number of them are located. Under prior law, group judicial appeals could only be made in the district court for the District of Columbia. Public Law 98-21 also requires certain appeals by providers which are under common ownership or control to be made as a group.

These provisions were included in a section of Public Law 98-21 entitled "Conforming Amendments" and were not assigned a specific effective date. Therefore, these provisions together with most of the prospective payment provisions will "apply to items and services furnished by . . . a hospital beginning with its first cost reporting period that begins on or after October 1, 1983."

Explanation of Provision

The amendment clarifies the effective date of the judicial review provisions.

Effective Date

Applies to court actions brought on and after the enactment of Public Law 98-21.

32. Access to Home Health Services (sec. 182 of the bill)

(a) Present Law

Current laws requires a physician to certify to a patient's health needs and establish a plan for his care before the patient can qualify for home health benefits. The Secretary is directed, however, to prescribe regulations to disqualify physicians from carrying out these functions for patients of any agency in which the physicians have a significant ownership interest or a significant financial or contractual relationship.

Explanation of Provision

The amendment permits a physician who has a financial interest in an agency which is a sole community provider to carry out the certification and plan-of-care functions for patients who will receive services from the agency. Existing regulations, which were intended to prevent potential conflicts of interests, have created a serious problem for the relatively few patients whose physicians have an interest in the only agency in the area. These patients have

been unable to qualify for home health benefits unless they switched physicians.

Effective Date

Enactment.

(b) Present Law

Current regulations specifying which physicians are disqualified from carrying out the certification and plan-of-care functions for the patients of a home health agency include physicians who are uncompensated officers or directors of incorporated agencies even though they have no financial interest in its operation.

Explanation of Provision

The amendment deletes from the list of disqualified physicians uncompensated officers or directors of incorporated agencies. These physicians do not stand to gain or lose from referrals to the agency.

Effective Date

Enactment.

33. Publication of Physician Assignment List (sec. 183 of the bill)

Present Law

Payment for physicians' services under Medicare is made by the part B carrier either to the doctor or to the beneficiary dependent upon whether or not the physician has accepted assignment for the claim. In the case of nonassigned claims, payment is made directly to the beneficiary on the basis of an itemized bill, paid or unpaid. The beneficiary is responsible for the deductible and coinsurance amounts plus any difference between the physician's actual charge and the Medicare-determined reasonable charge. Alternatively, the beneficiary may assign (i.e., transfer) his rights to payment to the physician provided the physician is willing to accept Medicare's reasonable charge determination as the full charge for covered services. If the physician accepts assignment, he bills the program directly and is paid Medicare's reasonable charge less any deductible and the coinsurance. He may not charge the beneficiary (nor can he collect from another party such as a private insurer) more than the applicable deductible and coinsurance amounts.

A physician may accept or refuse requests for assignments on a bill-by-bill basis, from different patients at different times, or from the same patient at different times. However, he is precluded from "fragmenting" bills for the purpose of circumventing reasonable charge limitations; he must either accept assignment or bill the patient for all of the services performed on one occasion.

When a physician accepts assignment, the beneficiary is protected against having to pay any difference between Medicare's determined reasonable charge and the physician's actual charge. Further, the patient never has to handle the paperwork in connection with the claim. Only about half of Medicare's claims are paid on an assignment basis. In the remaining cases, the beneficiary is liable

for any difference between the actual charge and the Medicare determined reasonable charge—an amount that can sometimes pose a financial burden.

Under current law, there is no established mechanism to provide Medicare beneficiaries with information as to whether or not a physician accepts assignment.

Explanation of Provision

The committee amendment requires the Secretary to annually prepare lists containing the complete names and addresses, assignments ratios and volume of services of each physician. It is the explicit intent of this Committee to give the Secretary flexibility to determine thresholds, if any, for inclusion of physicians in the list. For example, the Secretary may determine to publish lists of physicians who accept assignment for at least 25 percent of claims. The Committee believes that the Secretary should have flexibility, if appropriate, to exclude from the list, those physicians who infrequently perform services for Medicare beneficiaries (e.g., less than 50 or 100 services per year).

Such lists shall be prepared at least for each carrier jurisdiction, and, if practical, for smaller geographic areas such as cities, counties or ZIP-code areas. Carriers should organize the lists in a manner to be of most value to beneficiaries. For example, lists could be organized by specialty of physician and alphabetically within each specialty. In addition, where physicians practice in groups, carriers should indicate the names of all physicians within a group or, if not available, annotate the list in such a way that users of the list can find the group name and recognize that the statistics are group statistics.

Copies of the listing shall be made available in the Social Security District Offices and other locations as the Secretary determines to be appropriate. Copies should be made available to senior citizen organizations and may be made available to local news media.

Effective Date

Calendar years beginning after date of enactment.

34. Permitting Limited Provider Representation on Peer Review Organizations (sec. 184 of the bill)

Present Law

Under current law, no health care facility such as a hospital may be a peer review organization although they may perform "delegated review" for a peer review organization.[99] The law specifically prohibits the Secretary of HHS from contracting with an entity which is, or is affiliated with (through management, ownership or common control), a health care facility. The Secetary, by regulation, has interpreted this to mean that a peer review organization (PRO) may not have a governing body which has as a member any individual who is a governing body member, officer, or managing employee of a health care facility.

It is common among professional standards review organizations (PSRO's) (which are being phased out and replaced by PRO's) for one or two of the hospital administrators to sit on the PSRO board. The regulation could have the effect of prohibiting any physician or other person who is on the board of, or has certain administrative responsibilities in, a hospital from serving on the board of a PRO.

Explanation of Provision

The amendment provides for limited representation of providers on PRO's. In the case of a PRO with a governing body of 15 or fewer members, one such member may be a governing body member, officer, or managing employee of a health care facility; and in the case of a PRO with a governing body of more than 15 members, no more than two such members may be a governing body member, officer, or managing employee of a health care facility.

Effective Date

Enactment.

35. Prospective Payment Assessment Commission (sec. 185 of the bill)

Present Law

The "Social Security Amendments of 1983" (P.L. 98-21) provided for the implementation of a prospective payment system for hospitals under the Medicare program. The legislation established a new independent commission to assist the Department of Health and Human Services (HHS) and the Congress to deal with the issues that will arise with respect to the new payment method. This Prospective Payment Assessment Commission is required to make recommendations concerning the annual percentage increase factor for diagnosis related group (DRG) payment rates. The Commission is also required to make recommendations with respect to changes in the DRGs based on its evaluation of scientific evidence with respect to new practices, including the use of new technologies and treatment modalities.

Explanation of Provision

The amendment would make several clairfying changes. It would clarify that the Commission is an independent authority and responsible for requesting appropriations. The Commission would be exempt from competitive public bidding (considered to be too cumbersome for an organization of the Commission's size) and from open-meeting requirements. Further, HHS would be directed to provide the Commission with basic support services and be reimbursed out of funds of the Commission. Provision would also be made for the appointment of an executive director. The amendment would also authorize HHS to finance clinical trials.

Effective Date

Enactment.

36. Medicaid Clinic Administration (sec. 186 of the bill)

Present Law

By law, States may cover clinic services under their Medicaid programs to assure that the clinic services are provided on a safe and appropriate basis, regulations issued by the Department of Health and Human Services limit coverage to situations where services are furnished under the direction of a physician. In certain cases, the physician direction rule has been interpreted as requiring that clinic administrators be physicians.

Explanation of Provision

The amendment would direct the Department of Health and Human Services to modify the physician-direction requirement to clarify that the administrator of a clinic need not be a physician.

Effective Date

Enactment.

37. Eliminate Part B Penalty for Working Aged (sec. 187 of the bill)

Present Law

The "Tax Equity and Fiscal Responsibility Act" (TEFRA) required employers to offer their employees aged 65 to 69 the same health benefits plan offered to their younger workers. Medicare payments are secondary with respect to these older workers (and their spouses aged 65–69). Aged employees who elect enrollment in such employer offered health benefit plans may wish to delay enrollment in Part B because Part B coverage may be duplicative. However, these persons are currently subject to a late enrollment penalty. By law, the monthly Part B premium is increased by 10 percent for each full 12 months that an individual delays enrollment in the program beyond his or her initial enrollment period.

Explanation of Provision

The amendment would waive the Part B delayed enrollment penalty for workers and their spouses aged 65 to 70 who elect private coverage under the provisions of TEFRA and would establish special enrollment periods for such workers. The waiver would apply for the period during which an individual continued to be covered under an employer's group health benefits plan.

Effective Date

Enactment.

38. Hospital Emergency Room Services (sec. 188 of the bill)

Present Law

The "Omnibus Budget Reconciliation Act of 1981" (P.L. 97-35) included a provision requiring the Secretary of HHS to place reasonable limits on hospital costs and physician charges for outpatient services. The limits were to be reasonably related to the charges for similar services in physician's offices in the area. The statute specifically exempted from the outpatient limits "bona fide emergency services provided in an emergency room."

The Tax Equity and Fiscal Responsibility Act of 1982 (P.L. 97-248) included a provision to eliminate duplicate overhead payments for outpatient services. The provision added authority for the Secretary to reduce the payment to a physician providing services in an outpatient department by a factor representing the overhead costs already being paid by medicare through the payment to the hospital.

The Secretary of HHS issued implementing regulations for these provisions on October 1, 1982. The definition of "bona fide emergency services" was limited to services necessary to prevent death or serious impairment. After receiving public comment, the Department of HHS reconsidered the definition. Although the regulations have not yet been reissued, it appears that the Department is prepared to broaden the definition.

Explanation of Provision

The amendment would provide for the following statutory definition of "bona fide emergency services":

> Services provided in a hospital emergency room after the sudden onset of a medical condition manifesting itself by symptoms of sufficient severity (including severe pain) that the absence of immediate medical attention could reasonably be expected to result in (a) placing the patient's health in serious jeopardy; (b) serious impairment to bodily functions; or (c) serious dysfunction of any bodily organ or part.

The committee believes that a statutory definition of "bona fide emergency services" is necessary to express clearly the intent of Congress in this regard.

Effective Date

Services furnished on or after enactment.

39. Nurse Anesthetists (sec. 189 of the bill)

Present Law

Under the new prospective payment system enacted as a part of the Social Security Amendments of 1983 (P.L. 98-21), medicare's payments to hospitals under part A will be based on the diagnosis of the patient. Each diagnosis-related group (DRG) payment is in-

tended to cover all the services that hospitals customarily furnish in caring for patients with a specified diagnosis.

Certified registered nurse anethetists (CRNAs) have a variety of employment arrangements. Nearly 40 percent of all anesthesia services are provided by CRNAs employed by, or under contract with, hospitals. Certified registered nurse anesthetists who are paid by the hospital often assist at operations by anesthetising the patient. A part of each hospital's DRG payment is intended to cover these costs. However, a physician might also provide the anesthetic, and in these cases the physician can bill medicare separately. Since a hospital will be paid the same amount regardless of whether it pays a CRNA to perform the procedure or a physician gives the anesthetic at no cost to the hospital, there is a clear financial incentive for hospitals to have physicians replace CRNAs. Physicians who provide anesthesia can bill the medicare program directly under part B. These physicians may also employ nurse anesthetists and bill for their services through part B.

Public Law 98–21 provided that all non-physician services provided to hospital inpatients could only be paid for under part A. This would mean that the services of a CRNA employed by physician and currently billed under part B would have to have been billed under part A. Because such a result might disrupt the present employment relationship of CRNAs, the Department of Health and Human Services (HHS) in its regulations of September 1, 1983 established a temporary provision to provide for a transition with respect to the payment for the services of CRNAs billed under part B.

The regulations provide that, if a physician employed nurse anesthetists during a designated period prior to implementation of prospective payment, then that physician may continue to bill for CRNA services until the start of those hospital cost reporting periods beginning before October 1, 1986.

Explanation of Provision

The amendment provides that the costs a hospital actually incurs in employing CRNAs are to be reimbursed on a reasonable cost basis. The costs may not be based on a greater number of CRNAs than were employed by a hospital in 1982, unless the Secretary determines that patient volume, patient mix, or a loss of physicians' services requires otherwise.

The amendment further requires the Secretary to conduct a study and report to Congress on an alternative method for reimbursing for these services. Such alternative method should not discourage the use of CRNAs.

Effective Date

Hospital reporting periods beginning on and after October 1, 1984.

40. Prospective Payment Wage Index (sec. 190 of the bill)

Present Law

The "Social Security Amendments of 1983" (P.L. 98-21) provided for the implementation of a prospective payment system for hospitals under the Medicare Program. Under the system, payments made to hospitals are adjusted to reflect differences in hospital area wage levels compared to the national average. The wage index is calculated based on wage and employment data maintained by the Bureau of Labor Statistics (BLS) of the Department of Labor. The data is currently the most reliable national data available. However, it is an inadequate measure of wage differences because it fails to accurately reflect the relative use of part time and full time employees in calculating the index.

Explanation of Provision

The amendment would direct the Secretary of Health and Human Services to consult with the Secretary of Labor to develop methods of refining and improving the adequacy and equity of the area wage index, specifically its applicability to hospital wages. The Secretary of HHS would be required to report to the Congress by May 1, 1984.

The amendment would further require the Secretary to adjust, if found appropriate, a hospital's payment to reflect changes made in the index. Such adjustments would be made for reporting periods beginning on or after October 1, 1983. In making any necessary adjustment for the first reporting period beginning on or after October 1, 1984, any overpayment or underpayment that may have occurred in the previous cost reporting period would be taken into account.

Effective Date

Enactment.

41. Hospice Contracting (sec. 191 of the bill)

Present Law

Public Law 98-248, the "Tax Equity and Fiscal Responsibility Act of 1982", authorized for the period November 1, 1983 to October 1, 1986 Medicare Part A coverage for hospice services provided to terminally ill Medicare beneficiaries with a life expectancy of six months or less. The law specifies that a hospice must routinely provide directly, substantially all of the following "core services": nursing care, medical social services, physician's services, and counseling services. The remaining "non-core services" may be provided either directly by the hospice or under arrangements with others, in which case the hospice must maintain professional management responsibility for all such services furnished to an individual, regardless of the location or facility in which such services are furnished.

Under existing regulations, a hospice may use contracted staff to meet the "core service" needs of its patients but only when neces-

sary to supplement hospice employees during periods of peak patient loads or under extraordinary circumstances.

Explanation of Provision

The amendment would permit the Secretary to waive the nursing care "core services" requirements for hospices located in rural areas, which were in operation on or before January 1, 1983, and which have demonstrated a good faith effort to hire their own nurses. A waiver request would be granted automatically unless expressly denied by the Secretary within 60 days. The granting of a waiver would not preclude the favorable consideration of a subsequent waiver request should such a request be necessary.

In providing for this waiver, the Committee emphasizes that it does not support or condone the establishment of hospices which serve only as brokers for services. Hospices which receive such waivers would be expected to exert professional management responsibility over the services and would be accountable for assuring that they are rendered consistent with the plan of care.

The amendment would also require the Secretary to study the necessity and appropriateness of the core service requirement and report his/her findings to the Congress within 18 months of enactment. The Committee wishes to express its interest in having the Secretary make recommendations (1) for legislative action to further protect hospice patients and the medicare program from fraud and abuse and (2) standards of quality to be used in enlisting hospice services.

Effective Date

Enactment.

42. Payment for Psychiatric Hospitals (sec. 192 of the bill)

Present Law

Under the terms of a reimbursement experimentation contract with the State of New Jersey, Medicaid patients who need skilled nursing or intermediate facility care, but who are waiting in a hospital for placement in a nursing home, are subject to different reimbursement rules than those who need acute inpatient hospital services. If the Secretary determines that the hospital has no excess beds, and if there are no excess hospital beds in the hospital's service area, the reimbursement for patients awaiting nursing home placement is set at the hospital's acute care rate; otherwise, Medicaid reimbursement must reflect the level of care actually received by the patient. (A similar statutory provision which would make this policy applicable nationwide has not yet been implemented.)

The application of this policy to public psychiatric hospitals in New Jersey has created a problem for the State and some of its localities. After July 1, 1984, reimbursement for Medicaid patients in these facilities awaiting nursing home placement will no longer be set at the acute care rate, but will be lowered to the skilled nursing facility rate. This will result in a sudden drop in the Medicaid re-

imbursement rate to the affected facilities by as much as 50 percent.

The Committee believes that a gradual phase-in of the policy under the New Jersey reimbursement experiment would be more appropriate.

Explanation of Provision

The amendment delays until July 1, 1985, the application of any reimbursement reductions required to be made to public psychiatric hospitals due to the level of care received by Medicaid patients in such hospital. The bill further requires that one third of the reductions take effect during the year ending June 30, 1986, and that the remaining two-thirds of the reductions take effect during the year ending June 30, 1987.

Effective Date

Enactment.

43. Accreditation of Psychiatric Hospitals (sec. 193 of the bill)

Present Law

Under present law, psychiatric hospitals must be accredited by the Joint Commission on the Accreditation of Hospitals in order to participate in Medicare and Medicaid. Psychiatric units of general hospitals must also be accredited by the Joint Commission in order to receive Medicaid payments for the care of children.

Explanation of Provision

The amendment permits psychiatric hospitals and psychiatric units of general hospitals to participate in Medicare and Medicaid on the basis of a survey by the Secretary of Health and Human Services or, if found appropriate, accreditation by the American Osteopathic Association or the JCAH.

Effective Date

Enactment.

44. Teaching Physician Payments Under Medicare (sec. 194 of the bill)

Present Law

Under a provision of current law, which has not yet been implemented, teaching physicians who practice primarily in teaching hospitals may be paid charges for their services to medicare patients if charges are billed to other patients. The level of charges that is to be paid by medicare under present law is to be based on the amounts charged and collected for the nonmedicare patients.

Implementation of this policy could result in large payment reductions, and financial problems, for some teaching hospitals in States which have very low medicaid payment rates. These rates sometimes represent as little as 25 percent of the area's prevailing

charges. Their use in calculating medicare payment levels would reduce medicare reimbursement substantially.

Explanation of Provision

The amendment provides that the medicare reasonable charge for a physician's service furnished in a teaching hospital may not be less than 75 percent of the prevailing charge for that service in the locality.

Effective Date

Enactment.

45. Cardiac Pacemakers (sec. 195 of the bill)

Present Law

Current law provides for the services associated with the implantation of cardiac pacemakers and post-implantation monitoring of these devices to be reimbursed under Part B. A number of criticisms have been raised concerning current Medicare policies and practices relating to cardiac pacemakers.

The criticisms focus on the frequency of transtelephonic monitoring of pacemakers and fees for the implantation of pacemakers.

Explanation of Provisions

The amendment would require the Secretary of Health and Human Services to issue revisions by February 1, 1984 to the current coverage guidelines on the frequency of transtelephonic monitoring procedures which are reasonable and necessary. The Secretary is now reviewing Medicare policies in this area. As a part of this review, the American College of Cardiology, the American Heart Association, the American Medical Association, and many other organizations and individuals with expertise in this area will provide materials to the Department. It is anticipated that the February 1, 1984 date provides the Department the necessary time to complete its analysis and issue revised guidelines.

The amendment would require the Secretary to review and report to the Congress on the appropriateness of the current rate of physician reimbursement for services associated with implantation and replacement of pacemakers and pacemaker leads. In conducting this review, the Secretary is to take into account the amounts recognized as reasonable with respect to the procedures and the time and difficulty of the procedures compared to those when such rates were first established. The Committee thus intends that the Secretary shall take into consideration improvements of pacemaker implantation and reductions in the time required for such procedures that have occurred over the past decade.

The amendment requires the Secretary, through the Commissioner of the Food and Drug Administration (FDA), to provide for a manufacturer-based registry of all cardiac pacemaker devices and leads for which payments may be made under Medicare. The amendment would require manufacturers to maintain a registry on its devices and leads which includes: model identification, serial

number, the name of the recipient, the date and geographic location of the implantation or removal, and the name of the physician, hospital or other provider. The registry would include any express or implied warranties associated with the device and any other information which the Secretary deemed appropriate. The registry would be readily accessible to duly authorized agents of the Food and Drug Administration.

The purpose of the registry would be to assist the Secretary in determining when Medicare payments for a replacement pacemaker may properly be made, in determining when inspection by the FDA may be necessary for purposes of review and testing for malfunctions of pacemakers, tracing the performance of cardiac pacemaker devices and leads, and in carrying out such other studies as the Secretary may determine appropriate. The Secretary would be specifically prohibited from identifying any recipient of a pacemaker by name.

The Secretary would be authorized to require, by regulation, that all patients bearing a device or lead for which Medicare payment was made or requested be registered with the manufacturer of the device and lead. The Secretary could, also, by regulation, require that any device or lead explanted from any such patient be returned to the manufacturer of same. Failure to return an explanted device or lead could be grounds for the intermediary to deny payment for the replacement of such device or lead.

The amendment requires the manufacturers to maintain accurate records and report annually to the FDA on the results of all returned product analysis and on such other clinical experiences as are deemed appropriate. In the case of adverse performance, manufacturers would be required to provide prompt notification to the FDA.

The amendment authorizes the Secretary to require the manufacturer to test or analyze each returned cardiac pacemaker device or lead and provide the test results to the institution or party who returned it to the manufacturer together with information as to whether or not such unit qualifies for any warranty or other credit. In any case where the Secretary has reason to believe that replacement of a pacemaker is related to its malfunction, the Secretary may require that FDA personnel have access to the manufacturers testing records or may verify such testing.

Effective Date

Enactment.

46. Health Maintenance Organizations and Competitive Medical Plans (sec. 196 of the bill)

Present Law

Under current law, health maintenance organizations (HMOs) and competitive medical plans (CMPs) are required to have an open enrollment period of at least 30 days during which time they must accept medicare beneficiaries up to the limits of their capacity.

Explanation of Provisions

The amendment requires the Secretary to designate one 30-day period in which all of the CMPs and HMOs in an area participating in medicare must have an open enrollment period. The CMP or HMO would be permitted, in addition, to conduct open enrollment at other times during the year or hold enrollment open throughout the year. The Secretary would be required to establish annual per capita rates in a manner that assures that the beneficiaries enrolling during the designated 30-day open enrollment period will not have their premiums increased or their benefits decreased for the 12 month enrollment period for which the beneficiary is enrolling.

The Secretary, in establishing the open enrollment period for an area, would be directed to consult with the CMPs or HMOs in a geographic area concerning the timing of the annual 30-day open enrollment period. It is the intent of the committee that the majority of any CMPs annual enrollment occur during the coordinated open enrollment period.

The committee understands that there may be some difficulty in administering this provision and has therefore allowed the Secretary a period of not more than three years to phase in this provision. The committee intends that the Secretary make every effort to designate open enrollment periods for different areas as soon as possible and not wait until the second or third year of this period before designating open enrollment periods.

Effective Date

Enactment.

Other Considerations

Under a provision of the 1980 amendments, small rural hospitals are allowed to temporarily participate in medicare under certain circumstances even though they are unable to meet the medicare requirement that it provide 24-hour nursing. One of the conditions is that the hospital's lack of nursing must be due to a temporary nurses shortage and that the hospital is making a good faith effort to comply with the program's nursing standards.

The Committee believes that in assessing the hospital's efforts to attract personnel, consideration should be given to the economic conditions in the area in which the hospital is located and the communities ability to attract and pay skilled hospital staff and provide employment for a spouse. Specifically, factors such as rate of unemployment, relative poverty and hardship resulting from natural disasters or economic dislocation should be identified and given weight.

In the case of a facility which functions as a sole community provider, or where a hospital is located in a geographically remote area, care shall be taken to ensure that hospital emergency services continue to be accessible to area residents.

Estimated Savings

Fiscal years:	*Millions*
1984	$30
1985	100
1986	112
3-year total	$242

B. Income Maintenance Provisions

Aid to Families With Dependent Children (AFDC) Provisions

1. Parents and Siblings of Dependent Child Included in Filing Unit (sec. 197 of the bill)

Present Law

There is no requirement in present law that parents and all siblings be included in the AFDC filing unit. Families applying for assistance may exclude from the filing unit certain family members who have income which might reduce the family benefit. For example, a family might choose to exclude a child who is receiving social security or child support payments, if the payments would reduce the family's benefits by an amount greater than the amount payable on behalf of the child. In addition, a mother who is a minor is excluded if she is supported by her parents. However, if she has no income of her own which may be attributed to her child, the child may qualify for assistance as a one-person unit, and receive proportionately more in assistance than it would receive as part of a two-person unit. The income of the minor parent's parents is not considered in determining the eligibility of the child.

Explanation of Provision

The amendment approved by the committee would require States to include in the filing unit the parents and all dependent minor siblings (except SSI recipients and any stepbrothers and stepsisters) living with a child who applies for or receives AFDC. In addition, if a minor who is living in the same home as his parents applies for aid as the parent of a needy child, the income of the minor's parents would be counted as available to the filing unit. The rules that would be used in determining the amount of available income would be the same as are currently used in counting the income of stepparents.

This change will end the present practice whereby families exclude members with income in order to maximize family benefits, and will ensure that the income of family members who live together and share expenses is recognized and counted as available to the family as a whole. A similar provision was approved by the committee last year, but was dropped in conference with the House.

Effective Date

October 1, 1983.

Estimated Savings

[In millions of dollars]

	Fiscal year			Total
	1984	1985	1986	
Outlay effect	−100	−135	−140	−375

2. Households Headed by Minor Parents (sec. 198 of the bill)

Present Law

A minor parent who has a child, and who leaves home, may establish her own household and claim AFDC as a separate family unit. The income of the parents of the minor parent is not automatically counted as available to the minor parent, because they are not sharing the household.

Explanation of Provision

In the case of a minor parent who is not and has never been married, AFDC may be provided only if the minor parent resides with her parent or legal guardian, unless the State agency determines that (1) the minor parent has no parent or legal guardian who is living and whose whereabouts are known, (2) the health and safety of the minor parent or the dependent child would be seriously jeopardized if she lived in the same residence with the parent or legal guardian, or (3) the minor parent has lived apart from the parent or legal guardian for a period of at least one year prior to the birth of the child, or before claiming aid, whichever is later. The State agency would be given authority to make payments to a protective payee with respect to a minor parent affected by the provision, until the individual is no longer considered a minor by the State.

The committee approved a similar provision last year, but it was dropped in conference with the House.

Effective Date

October 1, 1983.

Estimated Savings

[In millions of dollars]

	Fiscal year—			Total
	1984	1985	1986	
Outlay effect	−15	−20	−20	−55

3. Clarification of Earned Income Provisions (sec. 199 of the bill)

Present Law

The AFDC statute was amended in 1981 to change the way in which earned income is counted for purposes of determining eligibility and benefit amounts. As amended by Public Law 97-35, the law currently requires the States to disregard the following amounts of a family's earned income—

Eligibility Determination: (1) the first $75 of monthly earnings for full time employment; and (2) the cost of care for a child or incapacitated adult, up to $160 per child per month.

Benefit Calculation: (1) the first $75 of monthly earnings for full time employment; (2) child care costs up to $160 per child per month; and (3) $30 plus one-third of earnings not previously disregarded.

The $30 plus one-third disregard is allowed only during the first 4 consecutive months in which a recipient has earnings in excess of the standard work expense and child care disregards.

Courts in several States have been asked to interpret whether the term "earned income" refers to the gross amount earned by an individual before deductions are taken (for income taxes, insurance, FICA, support payments, or other items, regardless of whether the deduction is voluntary or involuntary), or whether the term refers to net income, after such deductions are taken. Regulations issued by the Department of Health and Human Services require that the term be interpreted as referring to gross income. However, courts in two States have ruled that the term must be interpreted as referring to net income.

Explanation of Provision

The statute would be amended to make clear that the term "earned income" means the gross amount of earnings, prior to the taking of payroll or other deductions. The provisions in the AFDC statute which require that specified amounts of earned income be disregarded in determining eligibility and benefits have historically been interpreted as requiring that such amounts be deducted from gross, rather than net, earnings.

The committee agrees with the Department that there was no intention to change this interpretation when it approved the 1981

AFDC amendments. The committee notes that when the Congressional Budget Office estimated the savings expected to be derived from the changes in 1981, it followed the interpretation shared by the Department and the committee that the proposed disregards would apply to gross earnings.

Effective Date

Date of enactment.

Estimated Savings

[In millions of dollars]

	Fiscal year—			Total
	1984	1985	1986	
Outlay effect	−18	−24	−24	−66

4. CWEP Work for Federal Agencies (sec. 199A of the bill)

Present Law

The Omnibus Budget Reconciliation Act of 1981 authorized States to conduct community work experience programs "which serve a useful purpose." Employable recipients may be required to participate in these programs as a condition of eligibility for AFDC.

Explanation of Provision

The statute would be amended to make clear that the participation in a CWEP program may include work performed for a Federal office or agency. Such work would not be considered to constitute Federal employment, and the State agency would be required to provide appropriate workers' compensation and tort claims protection to each participant.

Effective Date

Date of enactment.

Estimated Savings

No budget effect.

5. Treatment of Student Earnings (sec. 199B of the bill)

Present Law

The statute provides that eligibility for AFDC benefits is limited to families with gross incomes (income before application of any disregards) at or below 150 percent of the State's standard of need. A provision was included in Public Law 97-377, the Job Training

Partnership Act, which amended the gross income limitation to allow States to disregard the income of an AFDC youth which is derived from a program carried out under that Act, in such amounts and for such period of time (not to exceed six months with respect to earned income) as the Secretary of Health and Human Services may provide in regulations.

Explanation of Provision

Under the committee amendment, for purposes of applying the gross income limitation, States would also be allowed to disregard the income of an AFDC child who is a full-time student, under the same limitations with respect to amounts and periods of time as are applied in the case of youths who participate in a program under the Job Training Partnership Act.

Effective Date

Date of enactment.

Estimated Costs

Negligible.

Supplemental Security Income (SSI) Provisions

1. Adjustment in SSI Benefits on Account of Retroactive Benefits Under Title II (sec. 199C of the bill)

Present Law

Legislation was enacted in 1980 (P.L. 96–265) aimed at ensuring that an individual's entitlement under the Old Age Survivors, Disability Insurance (OASDI) and Supplemental Security Income (SSI) programs would not result in windfall benefits. Under this legislation, OASDI benefits that are paid retroactively following the initial determination of eligibility, are reduced by the amount of any excess SSI benefits that are paid because the OASDI benefits have been received in a lump sum rather than in the months when regularly payable.

Explanation of Provision

The committee provision would amend the present requirement to allow the adjustment of benefits in additional situations. First, in the case where retroactive OASDI benefits are paid before the SSI benefits, but for the same period, the retroactive SSI amount otherwise payable would be reduced by the amount of SSI that would not be paid had OASDI been paid when regularly due. Second, OASDI benefits that are paid retroactively, following a period of suspension of benefits, would be reduced by the amount of SSI benefits that would not have been paid had the OASDI benefits been received in the months when regularly payable.

Finally, present law would be amended to coordinate the benefit adjustment provision with the SSI retrospective accounting system. Under present law, it is possible that the two-month lag in counting OASDI income for purposes of determining the SSI benefit

amount can result in adjustment for less than the full retroactive period. The proposed change would make it possible to adjust benefits paid for the entire retroactive period.

Effective Date

Applicable to retroactive benefits (either OASDI or SSI) payable after September 30, 1983.

Estimated Savings

[In millions of dollars]

	Fiscal year—			Total
	1984	1985	1986	
Outlay effect	−10	−16	−17	−43

2. Third Party Liability Collections (sec. 199D of the bill)

Present Law

The Child Support Enforcement (CSE) program is a Federal-State partnership under which States are required to have a program which locates absent parents, establishes family responsibility and sets forth and enforces support orders.

Explanation of Provisions

The amendment would require the Secretary to issue regulations which would require State CSE agencies to petition the court to include medical support as part of the child support order whenever health care coverage is available to the absent parent at a reasonable cost. In addition, the regulation would provide for improved information exchange between the CSE and medicaid agencies on the availability of health insurance coverage.

Effective Date

Enactment.

VI. COSTS OF CARRYING OUT THE RECONCILIATION PROVISIONS AND VOTE OF THE COMMITTEE

Budget Effects

In compliance with paragraph 11(a) of Rule XXVI of the Standing Rules of the Senate, the following statement is made relative to the budget effects of the reconciliation provisions as reported.

The budget effects of the provisions are summarized in the tables in Part III.

Vote of the Committee

In compliance with paragraph 7(c) of Rule XXVI of the Standing Rules of the Senate, the following statement is made relative to the vote by the committee on the motion to report the reconciliation recommendation. The reconciliation title was ordered favorably reported by a vote of 12 ayes and 4 noes.

VII. REGULATORY IMPACT AND OTHER MATTERS TO BE DISCUSSED UNDER SENATE RULES

Regulatory Impact

Pursuant to paragraph 11(b) of Rule XXVI of the Standing Rules of the Senate, the committee makes the following statement concerning the regulatory impact that might be incurred in carrying out the reconciliation provisions.

A. Revenue Provisions

Numbers of individuals and businesses who would be regulated

The provisions do not involve new or expanded regulation of individuals or businesses.

Economic impact of regulation on individuals, consumers, and business

The provisions have no regulatory economic impact on individuals, consumers or businesses other than indirectly through the operation of the tax provisions.

Impact on personal privacy

The provisions do not relate to the personal privacy of individuals.

B. Spending Reduction Provisions

Numbers of individuals and businesses who would be regulated

The provisions to a large extent reduce the current regulatory requirement placed on individuals and businesses.

Economic impact of regulation on individuals, consumers, and business

The provisions have no new substantial economic impact on individuals, consumers or businesses.

Impact on Personal Privacy

The provisions do not relate to the personal privacy of individuals.

C. Revenue and Spending Reduction Provisions

Determination of the amount of paperwork

Any change in the amount of paperwork that taxpayers and other individuals may have to do is incidental to their compliance with the provisions in the Internal Revenue Code the medicare and

medicaid programs or Aid to Families with Dependent Children program.

Other Matters

Consultation with Congressional Budget Office on budget estimates

In accordance with section 403 of the Budget Act, the committee advises that the Director of the Congressional Budget Office has examined the committee's estimates (as shown in Part III) and has submitted the following statement with respect to the committee provisions.

CONGRESSIONAL BUDGET OFFICE
U.S. CONGRESS
WASHINGTON, D.C. 20515

Rudolph G. Penner
Director

November 4, 1983

The Honorable Robert Dole
Chairman
Committee on Finance
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

In accordance with Section 202 of the Congressional Budget Act of 1974, the Congressional Budget Office has prepared the enclosed cost estimate for the reconciliation proposals adopted by the Senate Finance Committee on October 31, 1983. The estimates represent the budgetary effects of the Committee's legislative proposals relative to CBO's projections of current law costs except where pricing the committee proposal relative to baseline would produce a different result. In such cases, we have estimated the costs relative to both bases. We understand that the Committee on the Budget will use these estimates to determine how the Committee's legislative proposals compare to the reconciliation instructions contained in the First Concurrent Resolution on the Budget for Fiscal Year 1984.

Should the Committee so desire, we would be pleased to provide further details on this estimate.

Sincerely,

James Blum

for Rudolph G. Penner

cc: The Honorable Russell B. Long
Ranking Minority Member

CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

1. BILL NUMBER: Not yet assigned.

2. BILL TITLE: Not yet assigned.

3. BILL STATUS:

As adopted by the Senate Committee on Finance on October 31, 1983.

4. BILL PURPOSE:

The recommendations contain spending and revenue provisions in response to the instructions contained in the First Concurrent Resolution on the Budget for Fiscal Year 1984, H. Con. Res. 91.

Subtitle A contains the revenue provisions.

Subpart I—Individual Income Tax Provisions

Subpart I would modify the income eligibility requirements for income averaging, would postpone for two years the 15 percent net interest exclusion, and would require persons subject to the alternative minimum tax to make estimated quarterly payments to the Treasury.

Subpart II—Provisions Primarily Affecting Corporations

Subpart II would phase out the graduated corporate tax rates for corporations with income between $1 million and $1.4 million and would amend the collapsible corporation rules.

Subpart III—Taxpaper Compliance

Subpart III contains a variety of provisions designed to improve taxpayer compliance and curtail the use of abusive tax shelters. Part I of this subpart addresses tax straddles and foreign corporations; Part II deals with the withholding of tax on disposition of United States real property interests; and Part III includes reporting, penalty, and other tax compliance provisions.

Subpart IV—Tax-Exempt Entity Leasing Provisions

Subpart IV would change the tax treatment of property leased to foreigners and to the federal government, state and local governments, and other tax-exempt entities. Among other stipulations, this title would restrict the provision enacted in the Economic Recovery Tax Act of 1981 that permits the rehabilitation tax credit for property leased to tax-exempt institutions.

Subpart V—Capital Gains and Losses

Subpart V would reduce the holding period necessary for long-term capital gains treatment and decreases the amount of ordinary income against which capital losses may be offset.

Subpart VI—Boating Safety and Sport Fish Restoration

Subpart VI would alter the tax treatment of certain sport fishing equipment and certain bows and arrows and provides for financing of sport fish restoration and boating safety programs.

Subtitle B contains the spending provisions.

Part I—Medicare, Medicaid, and Other Health Provisions

Part I would fix the Medicare Part B premium at 25 percent of program costs in 1986, freeze prevailing changes for physician services in 1984, alter the fee schedule for Medicare reimbursement for clinical laboratory services, index the Medicare Part B deductible, provide Medicaid coverage to certain pregnant women, and make other changes in health programs.

Part II—Income Maintenance Provisions

Part II would require all parents and all dependent minor siblings to be included in the Aid to Families with Dependent Children (AFDC) Assistance Unit; allow a minor mother who has never been married to receive AFDC only if she resides with her parents, alter the payment of windfall benefits in the Supplemental Security Income (SSI) program and make other changes

5. ESTIMATED FEDERAL BUDGET EFFECT:

TABLE 1. SUMMARY OF FEDERAL BUDGET EFFECTS RELATIVE TO BASELINE (By fiscal year, in millions of dollars)

	1984	1985	1986	1987	1988
Revenue Effects	1,769	4,525	7,139	7,723	7,899
Spending Effects					
Budget Authority/ Authorization	-477	-861	-1,260	-1,483	-1,701
Outlays	-402	-888	-1,317	-1,519	-1,738

TABLE 2. REVENUE EFFECTS RELATIVE TO BASELINE BY SUBPART (By fiscal year, in millions of dollars)

Subpart	1984	1985	1986	1987	1988
Subtitle A					
Subpart I—Individual Income Tax Provisions	863	2,333	4,275	3,426	1,654
Subpart II—Provisions Primarily Affecting Corporations	111	252	424	520	552
Subpart III—Taxpayer Compliance	284	493	272	287	314
Subpart IV—Tax-Exempt Entity Leasing Provisions	511	1,011	1,848	3,161	5,032
Subpart V—Capital Gains and Losses	a/	424	307	315	333
Subpart VI—Boating Safety and Sport Fish Restoration	0	12	13	14	14
Revenue Total	1,769	4,525	7,139	7,723	7,899

a/ Gain of less than $5 million.

The reconciliation recommendations do not eliminate or create any new tax expenditures.

CBO has reviewed and concurs with estimates of the revenue effects of the reconciliation recommendations of the Committee on Finance prepared by the staff of the Joint Committee on Taxation. These recommendations will increase fiscal year revenues by the amounts shown above.

TABLE 3. SPENDING EFFECTS RELATIVE TO BASELINE BY PROVISION (By fiscal year, in millions of dollars)

Program and Provision	1984	1985	1986	1987	1988
Direct Spending					
Medicare					
Modify Part B Premium					
Budget Authority	0	0	-339	-517	-567
Outlays	0	0	-359	-517	-567
Freeze prevailing charges for physician services					
Budget Authority	-400	-659	-764	-864	-990
Outlays	-320	-630	-740	-830	-960
Hepatitis B vaccine					
Budget Authority	1	-1	-2	-3	-4
Outlays	2	-1	-2	-2	-4
Limitation on certain foot care services					
Budget Authority	-31	-40	-43	-46	-49
Outlays	-28	-40	-42	-45	-48
Fee schedule for clinical laboratory services					
Budget Authority	-100	-148	-51	0	0
Outlays	-75	-175	-70	0	0
Index Part B deductible					
Budget Authority	-66	-132	-183	-190	-195
Outlays	-50	-115	-180	-188	-192
Reduce reimbursement to home health agencies for DME					
Budget Authority	1	2	5	8	8
Outlays	-10	-20	-20	-25	-25
Delay implementation of single limit for SNFs					
Budget Authority	-1	-2	-3	-4	-3
Outlays	10	20	0	0	0
Hospital area wage index					
Budget Authority	a/	a/	a/	a/	a/
Outlays	a/	a/	a/	a/	a/
Medicaid					
Increase Medicaid ceilings for Puerto Rico and the Territories					
Budget Authority	20	20	20	20	20
Outlays	20	20	20	20	20
Third party liability collections					
Budget Authority	-30	-100	-112	-125	-139
Outlays	-30	-100	-112	-125	-139
Medicaid coverage of pregnant women					
Budget Authority	6	11	12	13	14
Outlays	6	11	12	13	14
Recertification of SNF/ICF patients					
Budget Authority	-8	-1	0	1	1
Outlays	-8	-1	0	1	1

TABLE 3. (Continued)

Program and Provision	1984	1985	1986	1987	1988
Payment for psychiatric hospitals					
Budget Authority	10	10	6	3	0
Outlays	10	10	6	3	0
Other					
Impact of Medicare proposals on Medicaid					
Budget Authority	-14	-20	15	29	30
Outlays	-14	-20	15	29	30
Impact of Medicare proposals on premiums					
Budget Authority	106	171	184	188	193
Outlays	106	171	184	188	193
Impact of Medicaid proposals on Medicare					
Budget Authority	1	5	8	13	11
Outlays	-25	-27	-29	-31	-33
Aid to Families with Dependent Children					
Include all adults and children in AFDC assistant unit					
Budget Authority	-100	-135	-140	-145	-150
Outlays	-100	-135	-140	-145	-150
Offsetting effects on					
Child Support Enforcement					
Budget Authority	4	5	5	5	5
Outlays	4	5	5	5	5
Medicaid					
Budget Authority	55	80	90	100	110
Outlays	55	80	90	100	110
Households headed by minor parents					
Budget Authority	-15	-20	-20	-20	-20
Outlays	-15	-20	-20	-20	-20
Offsetting effects on					
Medicaid					
Budget Authority	-4	-5	-5	-5	-5
Outlays	-4	-5	-5	-5	-5
Clarify current law regarding earned income					
Budget Authority	-18	-24	-24	-24	-24
Outlays	-18	-24	-24	-24	-24
Earned income of full-time students					
Budget Authority	b/	b/	b/	b/	b/
Outlays	b/	b/	b/	b/	b/
Supplemental Security Income					
Windfall benefits					
Budget Authority	-10	-16	-17	-18	-19
Outlays	-10	-16	-17	-18	-19
TOTAL DIRECT SPENDING					
Budget Authority	-593	-999	-1,378	-1,581	-1,773
Outlays	-494	-1,012	-1,428	-1,616	-1,813

TABLE 3. (Continued)

Program and Provision	1984	1985	1986	1987	1988
Authorizations					
Maternal and Child Health Block Grant					
Authorization Change	79	57	35	9	-18
Outlays	55	64	42	17	-10
Sport Fish Restoration Program					
Authorization Change	0	28	29	30	30
Outlays	0	7	15	21	25
Food Stamps- Offsetting effects on AFDC and SSI Provisions					
Authorization Change	37	53	54	59	60
Outlays	37	53	54	59	60
TOTAL AUTHORIZATIONS					
Authorization Change	116	138	118	98	72
Outlays	92	124	111	97	75

a/ This proposal would direct the Secretary of Health and Human Services to study, refine and improve the Hospital area wage index. Any costs or savings resulting from adjustments to the Hospital area wage index in the first reporting period after October 1, 1983 would be offset in the next period.

b/ Less than $500,000.

The Authorization outlay estimates assume full appropriation of authorization levels. In the Maternal and Child Health Block Grant, the estimates shown in Table 3 are relative to the baseline. The estimates relative to current law are displayed below:

(By fiscal year, in millions of dollars)

	1984	1985	1986	1987	1988
Authorization Change	53	80	82	82	82
Estimated Outlays	37	72	81	82	82

6. ESTIMATED COST TO STATE AND LOCAL GOVERNMENTS:

The expenditures of state and local governments would be affected by the AFDC and Medicaid provisions of this bill. Their estimated impact is shown below:

Estimated Changes in State and Local Expenditures

(By fiscal year, in millions of dollars)

	1984	1985	1986	1987	1988
AFDC	-113	-152	-157	-161	-165
Medicaid	13	-21	5	14	9
Total	-100	-173	-152	-147	-156

All of the AFDC proposals would decrease both federal and state and local AFDC expenditures. The current state financing share is 46 percent.

The impact on the Medicaid program is more complex. State and local costs and savings result directly from changes in the Medicaid program, and indirectly from changes in the Medicare and AFDC programs. The Medicaid proposals in this bill would reduce federal, state and local expenditures, while the AFDC provisions would increase costs to both the federal and state Medicaid program. Finally, some changes in the Medicare program would increase Medicaid costs while other changes would decrease Medicaid costs. For example, freezing physician fees would result in lower reimbursement and thus reduce Medicaid expenditures. Indexing the Part B deductible would result in an increased cost to beneficiaries that Medicaid would pay for its joint Medicare/Medicaid recipients. Approximately 15 percent of Medicare recipients are also eligible for Medicaid. These effects lead to the pattern of state and local Medicaid changes shown above.

In addition, federal funds provided under this bill may defray current expenditures for the health care of the populations in the territories of the United States. The territories would also be required to match this additional funding. Because the current health care expenditure of the territories is not known, we are unable to estimate the change in their expenditures resulting from this provision.

7. ESTIMATE COMPARISON: None.

8. PREVIOUS CBO ESTIMATE: None.

9. ESTIMATE PREPARED BY:

Revenue Estimates - Rosemary Marcuss (226-2687)
Steve Porter (226-2678)
Spending Estimates - Diane Burnside (226-2860)
Hinda Ripps Chaikind (226-2820)
Janice Peskin (226-2835)

10. ESTIMATE APPROVED BY:

C. G. Nuckols for
James L. Blum
Assistant Director
for Budget Analysis

New budget authority

In compliance with section 308(a)(1) of the Budget Act, and after consultation with the Director of the Congressional Budget Office, the committee states that the bill, on balance, reduces budget authority. The provisions that reduce reimbursement to home health agencies for durable medical equipment, increase medicaid ceilings for Puerto Rico and the Territories, require medicaid coverage of pregnant women, and delay reductions in payments to psychiatrict hospitals increase budget authority. In addition, the offsetting effects of certain medicare, medicaid, and AFDC provisions also increase budget authority. The other spending provisions in the bill reduce budget authority or a neutral in their effect on budget authority. More detailed information is presented in Part III, B. —.

Tax expenditures

In compliance with section 308(a)(2) of the Budget Act with respect to tax expenditures, and after consultation with the Director of the Congressional Budget Office, the committee states that the bill, on balance, reduces total tax expenditures. The provision that reduces the minimum holding period required for long-term capital gain treatment increases tax expenditures. The other provisions in the bill reduce tax expenditures or are neutral in their effect on tax expenditures. More detailed information is presented in the discussions of the individual provisions and in Part III, A., Revenue Effects of Tax Provisions.

VIII. CHANGES IN EXISTING LAW

In the opinion of the committee, it is necessary, in order to expedite the business of the Senate, to dispense with the requirements of paragraph 12 of Rule XXVI of the Standing Rules of the Senate (relating to the showing of changes in existing law made by the reconciliation provisions, as reported by the committee).

COMMITTEE ON GOVERNMENTAL AFFAIRS

Title II

WILLIAM V. ROTH, JR., DEL., CHAIRMAN
CHARLES H. PERCY, ILL.
TED STEVENS, ALASKA
CHARLES MC C. MATHIAS, JR., MD.
WILLIAM S. COHEN, MAINE
DAVID DURENBERGER, MINN.
WARREN B. RUDMAN, N.H.
JOHN C. DANFORTH, MO.
THAD COCHRAN, MISS.
CHILLIAS L. ARMSTRONG, COLO.
THOMAS F. EAGLETON, MO.
HENRY M. JACKSON, WASH.
LAWTON CHILES, FLA.
SAM NUNN, GA.
JOHN GLENN, OHIO
JIM SASSER, TENN.
CARL LEVIN, MICH.
JEFF BINGAMAN, N. MEX.
JOAN M. MC ENTEE, STAFF DIRECTOR
IRA S. SHAPIRO, MINORITY STAFF DIRECTOR

United States Senate
COMMITTEE ON
GOVERNMENTAL AFFAIRS
WASHINGTON, D.C. 20510

October 31, 1983

The Honorable Pete V. Domenici
Chairman
Committee on the Budget
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman;

Enclosed are two revisions to our budget reconciliation legislation.

Since the Committee reported legislation to the Budget Committee on September 23, 1983, it has become apparent that without further revision, federal retirees would receive their COLA on differing dates. Specifically, some federal retirees would receive their COLA adjustments in December, 1984 while others would receive such adjustments in January 1985. The intent of the Senate, and of the Governmental Affairs Committee, was to provide that all COLA's for federal retirees would be payable on January 1, 1985. The enclosed revision will effect this policy. However, this amendment may affect retirees who are under the direct spending authority of other Committees. If this amendment is found to be objectionable to any such Committee, we would, of course, withdraw it.

In addition, since our recommendations were reported to you in September, one of our provisions has been enacted in law. We therefore ask that you delete Section 206 from our earlier recommendation, and renumber the remaining sections accordingly.

Sincerely,

Tom

Thomas F. Eagleton
Ranking Minority Member

Bill

William V. Roth, Jr.
Chairman

(185)

BEST COPY AVAILABLE

WILLIAM V. ROTH, JR., DEL., CHAIRMAN
CHARLES H. PERCY, ILL.
TED STEVENS, ALASKA
CHARLES MC C. MATHIAS, JR., MD.
WILLIAM S. COHEN, MAINE
DAVID DURENBERGER, MINN.
WARREN B. RUDMAN, N.H.
JOHN C. DANFORTH, MO.
THAD COCHRAN, MISS.
WILLIAM L. ARMSTRONG, COLO.
THOMAS F. EAGLETON, MO.
HENRY M. JACKSON, WASH.
LAWTON CHILES, FLA.
SAM NUNN, GA.
JOHN GLENN, OHIO
JIM SASSER, TENN.
CARL LEVIN, MICH.
JEFF BINGAMAN, N. MEX.
JOAN M. MC ENTEE, STAFF DIRECTOR
IRA S. SHAPIRO, MINORITY STAFF DIRECTOR

United States Senate
COMMITTEE ON
GOVERNMENTAL AFFAIRS
WASHINGTON, D.C. 20510

September 23, 1983

The Honorable Pete V. Domenici
Chairman
Committee on the Budget
Washington, D.C. 20510

Dear Mr. Chairman:

In accordance with the reconciliation instructions in H. Con. Res. 91, the First Concurrent Resolution on the Budget, we have enclosed the recommendations of the Governmental Affairs Committee to effect the required budgetary savings. The Committee has approved changes which will affect Civil Service retirement and pay. Parallel changes will also result in several programs over which the Committee on Governmental Affairs has no direct jurisdiction, because they are linked by law to Civil Service pay and retirement.

The Committee has adopted legislation to delay the cost-of-living adjustment (COLA) for Civil Service retirees, and to make an accompanying technical revision in the computation of these adjustments. Since the budgetary assumptions made in H. Con. Res. 91 did not reflect this technical revision, the savings associated with the COLA delay in the reconciliation instructions were somewhat higher. However, we believe that a review of our revision in this area will confirm that this computation method is clearly the preferred alternative. Because the Committee has approved major legislative changes which will result in significant budgetary savings, we believe we have complied with the reconciliation instructions to the maximum extent possible, at this time.

We have enclosed a report discussing these recommendations.

Sincerely,

Tom

Thomas F. Eagleton
Ranking Minority Member

Bill

William V. Roth, Jr.
Chairman

Enclosures

BEST COPY AVAILABLE

Summary of Reconciliation Proposals

H. Con. Res. 91 requires the Committee on Governmental Affairs to report legislation to achieve savings to the Committee on the Budget by September 23, 1983.

Briefly, a delay in the retiree cost-of-living adjustment COLA and a delay and a cap in the civil service employee raise are assumed by the resolution. In addition to effecting savings in this committee, these changes will result in large savings in several other programs, such as military retirement, which are linked by law to civil service programs but over which the Governmental Affairs Committee has no direct jurisdiction.

SECTION 201

Cost-of-living adjustments under civil service retirement

Section 201 permanently delays the civil service retirement COLA until January of each year, and revises the computation period on which the COLA is based to reflect this change. The next retiree COLA will be given in January 1985, a seven-month delay from the next scheduled COLA, under existing law.

Computation period

While H. Con. Res. 91 assumes a delay in the COLA for retirees until January 1985, no accompanying delay in the underlying computation period was assumed.

Under current law, the COLA percent which was given to retirees in April 1983 was computed by dividing the fourth quarter 1982 CPI by the fourth quarter 1981 CPI. That is, the COLA is computed from the difference in the CPI in the final quarters of the preceding 2 years.

If the COLA is delayed to be payable in January, its effective date would take place in the preceding month, which is December. The computation period under current law, however, would still be the preceding two Decembers. In other words, the COLA to be given in January 1985, would be based on the CPI change from December 1982 to December 1983, and would thus be a full year old.

To close this gap, the computation period must be revised. The most timely computation could be made from the third quarters of successive years. This is the same base period used to compute the recently revised social security COLA.

SECTION 202

Pay comparability adjustment for Federal employees

Section 202 delays the pay comparability raise for civil service employees from October until January, and sets the fiscal year 1984 pay raise at 4 percent.

H. Con. Res. 91 further assumes savings in this area in fiscal years 1985 and 1986 which would result from a limitation of the pay raise in each of these years. The Committee on Governmental Affairs believes it is not appropriate to impose ceilings on Federal employee pay in these years at this time, because of several intervening circumstances.

Federal pay is an area in which the committee has an ongoing interest in reform. To set ceilings on pay over this period could conflict with committee work in this area. Further, placing ceilings on Federal pay in these years could seriously interfere with labor negotiations between various Federal employee unions and the Federal Government.

The recent Supreme Court decision on the use of the legislative veto, *I.N.S.* v. *Chadha,* raises fundamental questions on the process through which the annual pay comparability adjustment is made. The committee has not had an opportunity to determine the full impact of this decision yet, but intends to address this issue this year.

SECTION 203

Retired or retainer pay

Section 203 repeals the military offset provision enacted last year as part of the reconciliation bill.

Currently, military retirees who serve in the civil service have their pay reduced by the amount of the cost-of-living adjustment received through their military retirement. This provision would eliminate this pay reduction.

SECTION 204

Leave for certain overseas employees

Section 204 adjusts the manner in which teachers in the Department of Defense Dependents Schools (DODDS) accumulate leave.

This provision is necessary because the cap on maximum leave accumulation places teachers who have reached that maximum in the position of using or losing leave. Use of leave, in turn, requires DODDS to hire substitute teachers.

Specifically, the 75-day limitation on the total amount of leave a teacher may accumulate, would be removed by the provision. According to the General Accounting Office, this would save the Department of Defense $3.3 million in substitute teacher pay.

The existence of the cap dates back to the pay system for teachers in existence prior to the enactment of the 1959 Defense Department Overseas Teachers Pay and Personnel Practices Act. When this act was passed, the method of calculating teacher pay was changed, but the leave provision was not adjusted. This provision makes this adjustment. It enables DODDS teachers to accumulate leave at the same rate and in the same manner as other civil service employees. The limit on such leave accumulation for civil service employees was removed by the annual Sick Leave Act of 1951.

SECTION 205

Civil service retirement deposits covering military service

Section 205 extends a provision enacted last year, which permitted veterans to make contributions to acquire credit for service under the civil service retirement system, for which they were not previously eligible.

A complex solution to the problem known as "Catch 62" was included in the budget reconciliation legislation enacted last year. "Catch 62" describes a problem in which veterans who worked in the civil service would find their military service removed from their civil service retirement computation after the age of 62. The revision passed last year allowed current civil servants to make a contribution of 7 percent of their military base pay for that period of military service, in order to allow them to maintain their credit in civil service retirement.

This section permits those who retired after September 8, 1982, and before October 1, 1983, to make the necessary contributions until October 1985. The law currently allows them to make a payment before October 1, 1983, even though they are currently retired. Retirement generally precludes making payments to gain credit for this period of service. However, military pay centers have been slow in retrieving old military pay records and therefore, many people who want to make the necessary contributions have been unable to, due to the October 1 deadline. This amendment simply gives them another 2 years to make those payments.

SECTION 206 [1]

Computation of hourly rate of pay of certain Federal employees

Section 206 would delay the increase in Federal work hours from October 1983 to January 1984.

The budget reconciliation legislation enacted last year changed the base pay computation from 2,080 hours to 2,087 hours. This change is to be effective October 1, 1983. However, the next pay adjustment is likely to occur in January 1984, and without this revision, Federal employees will find their pay reduced in October and increased in January.

H.R. 3871, which would effect this same delay, has passed the House and is currently being held at the desk for Senate action as the committee considers this legislation.

SECTION 207 [2]

Pay increases for certain employees in Panama

Section 207 amends section 1225 of the Panama Canal Act of 1979. It would result in Federal employee wages in the Canal Zone being adjusted at the same time and by the same annual amount as are those of General Schedule employees.

Currently, employees hired *after* October 1, 1979, by Federal agencies in the Panama Canal area are to be given at least a 2 percent pay increase on October 1 of each year. Since it appears that the wages of Federal employees in the United States will be adjusted on January 1, 1984, employees hired *before* October 1, 1979, in Panama will not receive an increase until January.

This provision would correct this inequity in fiscal year 1984, and would permit future pay increases for all employees in Panama to

[1] Deleted from bill pursuant to revised submission of Oct. 31, 1983. (See Governmental Affairs Committee letter of Oct. 31, 1983, to Senator Domenici, supra.)

[2] Renumbered section 206.

correspond, in both amount and timing, with pay increases for Federal employees in the United States.

CBO Cost Estimate

CONGRESSIONAL BUDGET OFFICE
U.S. CONGRESS
WASHINGTON, D.C. 20515

Rudolph G. Penner
Director

October 31, 1983

The Honorable William V. Roth, Jr.
Chairman
Committee on Governmental Affairs
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

Pursuant to Section 202 of the Congressional Budget Act of 1974, the Congressional Budget Office has prepared the enclosed cost estimate for the reconciliation proposals adopted by the Senate Committee on Governmental Affairs on September 23, 1983 and revised on October 31, 1983. The estimates represent the budgetary effects of the Committee's legislative proposals relative to CBO's projections of the costs of current law except where pricing the Committee proposal relative to CBO's baseline would produce a different result. In such cases, pricing relative to both bases is included. We understand that the Committee on the Budget will use these estimates to determine how the Committee's legislative proposals compare to the reconciliation instructions contained in the First Concurrent Resolution on the Budget for Fiscal Year 1984.

With respect to the pay comparability adjustment for federal civilian employees, the estimate shows savings resulting from the pay cap of 4.0 percent in 1984 proposed by the Committee, when measured relative to the CBO baseline (which assumes 5.5 percent in 1984). For your information, if the proposed pay cap of 4.0 percent were extended to 1985-1988, the additional savings that would result are shown in the following table.

BUDGETARY EFFECTS OF OPTIONS TO CHANGE ANNUAL PAY COMPARABILITY ADJUSTMENTS (By fiscal year, in millions of dollars)

Program and Budget Function	1984	1985	1986	1987	1988
Committee Proposed Pay Cap with Permanent 3-Month Delay					
Civilian Agency (920) and Dept. of Defense (050) Employees					
Authorization Level	-1,250	-1,502	-1,636	-1,771	-1,886
Outlays	-1,260	-1,546	-1,681	-1,818	-1,935
Offsetting Receipts (950)					
Authorization Level	78	87	96	105	114
Outlays	78	87	96	105	114
Net Budgetary Effect					
Authorization Level	-1,172	-1,415	-1,540	-1,666	-1,772
Outlays	-1,182	-1,459	-1,585	-1,713	-1,821

The Honorable William V. Roth, Jr.
October 31, 1983
Page two

(Budgetary Effects Continued)

Program and Budget Function	1984	1985	1986	1987	1988
Extend Proposed Pay Cap to 1985-1988					
Civilian Agency (920) and Dept. of Defense (050) Employees					
Authorization Level	--	-341	-839	-1,381	-1,974
Outlays	--	-342	-860	-1,421	-2,038
Offsetting Receipts (950)					
Authorization Level	--	19	33	51	79
Outlays	--	19	33	51	79
Net Budgetary Effect					
Authorization Level	--	-322	-806	-1,330	-1,895
Outlays	--	-323	-827	-1,370	-1,959
Total Budgetary Effect					
Civilian Agency (920) and Dept. of Defense (050) Employees					
Authorization Level	-1,250	-1,843	-2,475	-3,152	-3,860
Outlays	-1,260	-1,888	-2,541	-3,239	-3,973
Offsetting Receipts (950)					
Authorization Level	78	106	129	156	193
Outlays	78	106	129	156	193
Net Budgetary Effect					
Authorization Level	-1,172	-1,737	-2,346	-2,996	-3,667
Outlays	-1,182	-1,782	-2,412	-3,083	-3,780

Should the Committee desire, we would be pleased to provide further details on this estimate.

Sincerely,

Rudolph G. Penner
Director

cc: The Honorable Thomas F. Eagleton
Ranking Minority Member

CONGRESSIONAL BUDGET OFFICE

COST ESTIMATE

October 31, 1983

1. BILL NUMBER: Not yet assigned.

2. BILL TITLE: Not yet assigned.

3. BILL STATUS:

As adopted by the Senate Committee on Governmental Affairs on September 23, 1983.

4. BILL PURPOSE:

The Committee's reconciliation proposals would achieve the following: Section 201 would permanently delay future annual cost-of-living adjustments (COLAs) received by federal retirees until January of each year. Section 202 would limit the federal pay comparability adjustment for fiscal year 1984 to 4.0 percent and would delay all future annual pay comparability adjustments for General Schedule and related white-collar employees from October until January of each year. Section 203 would advance the date now set under current law for the repeal of the military retired pay offset provision whereby military retirees who serve in a federal civilian position have their pay reduced by the amount of the COLA received through their military retirement. Section 204 would adjust the method by which teachers in the Department of Defense Dependent Schools (DoDDS) accumulate leave. Section 205 would extend through fiscal year 1985 a provision of current law that permits military veterans to make contributions to receive credit for service under Civil Service Retirement for which they were not previously eligible. Section 206 would adjust the amount and timing of the pay adjustment for civilian employees working in the Panama Canal Zone to the same rate and time as that of regular General Schedule employees.

5. ESTIMATED COST TO THE FEDERAL GOVERNMENT:

This bill would change the estimated level of authorizations for funding of entitlement programs and programs for which future appropriations would be discretionary. This estimate assumes that future appropriations for such programs would conform to the changes proposed in this bill. The bill would also permit spending changes in programs for which further appropriations would not be necessary. Finally, the bill would result in changes to revenues.

Table 1 summarizes the estimated spending and revenue effects that would result from enactment of the Committee's recommendations relative to both current law and to CBO's baseline. The CBO baseline was the basis for the reconciliation instructions in the first budget resolution for 1984. With respect to the scope of the Committee proposal, the baseline differs from current law in the area of annual pay comparability adjustments, and to a much smaller extent in the area of the two-tier pay schedule that currently exists for certain employees of the Panama Canal Commission. These differences are covered later in the discussion of the relevant sections of the Committee proposal. Subsequent tables provide more detailed information.

TABLE 1. SUMMARY OF BUDGETARY EFFECTS
(By fiscal year, in millions of dollars)

	1984	1985	1986	1987	1988
Relative to Current Law					
Amounts Subject to Appropriation Action					
Authorization Level/					
Budget Authority	33	-2,020	-849	-880	-916
Outlays	40	-2,013	-847	-877	-916
Direct Spending Provisions					
Budget Authority	-30	30	--	--	--
Outlays	-276	-364	-688	-758	-825
Revenue	-30	30	--	--	--
Relative to CBO Baseline					
Amounts Subject to Appropriation Action					
Authorization Level/					
Budget Authority	-1,407	-3,163	-2,100	-2,243	-2,375
Outlays	-1,419	-3,207	-2,143	-2,290	-2,424
Direct Spending Provisions					
Budget Authority	-30	30	--	--	--
Outlays	-276	-364	-688	-758	-825
Revenue	-30	30	--	--	--

Basis of Estimate:

The estimate assumes that the Committee proposals will be enacted by December 31, 1983.

Section 201. Savings in Civil Service Retirement (CSR) and Foreign Service Retirement result from the proposal to delay the cost-of-living adjustment (COLA) until January of each year beginning in 1985. For Military, Public Health Service (PHS) and Coast Guard Retirement, this results in a change in current practice. Under current law the benefit checks for these three programs are issued during the same month in which the COLA is effective. This proposal mandates that benefit checks be paid in the month following the effective date of the COLA beginning in fiscal year 1985. As a result, retirees in these three programs will receive eleven monthly benefit checks in fiscal year 1985 instead of twelve checks. The 1985 savings in Military, PHS, and Coast Guard Retirement reflect this one-time accounting change.

The reconciliation language proposed for CSR also would delay the base period for calculating the COLA from the current December-to-December period to the third calendar quarter of one year to the third calendar quarter of the next. The changes proposed for CSR COLAs would affect other programs that are linked to it by current law. The savings for these other retirement programs are shown in Table 2.

TABLE 2. SAVINGS FROM PROPOSAL TO CHANGE COLAS FOR THE CIVIL SERVICE RETIREMENT PROGRAM (By fiscal year, in millions of dollars)

Program and Budget Function	1984	1985	1986	1987	1988
Civil Service Retirement (600)					
Budget Authority	--	--	--	--	--
Outlays	-273	-360	-680	-751	-817
Military Retirement (050)					
Budget Authority*	-252	-1,762	-540	-560	-583
Outlays	-252	-1,762	-540	-560	-583
Foreign Service Retirement (600)					
Budget Authority	--	--	--	--	--
Outlays	-3	-4	-8	-7	-8
Public Health Service (550)					
Budget Authority*	-1	-7	-3	-3	-4
Outlays	-1	-7	-3	-3	-4
Coast Guard (400)					
Budget Authority*	-5	-35	-13	-12	-14
Outlays	-5	-35	-13	-12	-14
Total COLA Savings					
Budget Authority	-258	-1,804	-556	-575	-601
Outlays	-534	-2,168	-1,244	-1,333	-1,426

* Entitlements subject to further appropriations action.

Section 202. Table 3 shows the budgetary effects that would result from the proposed cap on the fiscal year 1984 pay adjustment of 4.0 percent, effective January 1984 for General Schedule and related white-collar employees and uniformed employees of civilian agencies (an effective rate of 3.0 percent on a fiscal year basis), and throughout the year without delay beginning October 1983 for prevailing rate (blue-collar) employees. For 1985-1988, the assumed rates of pay increase are those in the CBO baseline but with an effective date of January each year for all employees except blue-collar, whose pay adjustments are assumed to continue to occur throughout the year without delay, beginning October of each year. The Committee proposal makes no explicit change in the level of pay raises for 1985-1988 so Table 3 excludes any such effects; the proposal does, however, explicitly provide for a permanent three-month delay of the effective date of such pay raises each year from October until January for General Schedule and related white-collar employees.

TABLE 3. BUDGETARY EFFECTS FROM PROPOSAL FOR 1984 PAY CAP AND DELAY IN EFFECTIVE DATE RELATIVE TO CURRENT LAW (By fiscal year, in millions of dollars)

Program and Budget Function	1984	1985	1986	1987	1988
Savings					
Civilian Agency Employees (920)					
Authorization Level	111	-217	-228	-241	-250
Outlays	124	-217	-228	-239	-250
Dept. of Defense Employees (050)					
Authorization Level	170	-75	-83	-88	-91
Outlays	165	-68	-83	-87	-91
Subtotal, Savings					
Authorization Level	280	-292	-311	-329	-341
Outlays	289	-285	-311	-326	-341
Offsetting Receipts					
Employer Share, Employee Retirement (950)					
Authorization Level	-12	20	22	26	28
Outlays	-12	20	22	26	28
Net Budgetary Effect					
Authorization Level	268	-272	-289	-303	-313
Outlays	277	-265	-289	-300	-313

The budgetary effects shown in Table 3 are measured relative to current law, which assumes that the President's alternative pay comparability plan has taken effect as of October 1983, pursuant to section 5305 of title 5, United States Code. This plan authorizes for General Schedule and related white-collar employees a 1984 pay

adjustment of 3.5 percent, effective January 1984. The Continuing Appropriations Resolution for Fiscal Year 1984 (Public Law 98-107), however, caps the 1984 pay adjustment for most blue-collar employees at 3.5 percent, which would occur throughout the year beginning October 1983. Moreover, the Department of Defense Authorization Act of 1984 (Public Law 98-97) calls for a 1984 pay raise of 4.0 percent (effective January) for uniformed employees, including those in the Coast Guard and other civilian agencies whose costs are a part of budget function 920. The applicable effects of these laws are now included in CBO's estimate of the costs of current law as well. Since the President's plan makes no explicit changes in 1985-1988, the rates of pay adjustments in those years are assumed to be those in the CBO baseline, effective October of each year.

As requested by the Committee staff, Table 4 shows the budgetary effects that would result if the Committee's pay proposal were measured relative to the CBO baseline (which assumes 5.5 percent in 1984 and 4.8 percent in 1985-1988, effective October of each year, for all employees). The budgetary effects shown in Tables 3 and 4 include changes in contributions of federal agencies (as employers) to Civil Service Retirement that would result from enactment of this provision.

TABLE 4. BUDGETARY EFFECTS FROM PROPOSAL FOR 1984 PAY CAP AND DELAY IN EFFECTIVE DATE RELATIVE TO THE CBO BASELINE (By fiscal year, in millions of dollars)

Program and Budget Function	1984	1985	1986	1987	1988
Savings					
Civilian Agency Employees (920)					
Authorization Level	-736	-845	-887	-929	-974
Outlays	-761	-893	-935	-979	-1,025
Dept. of Defense Employees (050)					
Authorization Level	-514	-657	-749	-842	-912
Outlays	-499	-653	-746	-839	-910
Subtotal, Savings					
Authorization Level	-1,250	-1,502	-1,636	-1,771	-1,886
Outlays	-1,260	-1,546	-1,681	-1,818	-1,935
Offsetting Receipts					
Employer Share, Employee Retirement (950)					
Authorization Level	78	87	96	105	114
Outlays	78	87	96	105	114
Net Budgetary Effect					
Authorization Level	-1,172	-1,415	-1,540	-1,666	-1,772
Outlays	-1,182	-1,459	-1,585	-1,713	-1,821

Section 203. As a result of the Omnibus Reconciliation Act of 1982, most military retirees employed by the federal government as civilians have their salaries reduced whenever their retired pay is adjusted for cost-of-living increases. These dollar-for-dollar reductions are temporary and are scheduled to end at the beginning of fiscal year 1986. Section 203 would advance this termination date and thus increase the government's payroll costs in fiscal years 1984 and 1985. The CBO estimate assumes that approximately 100,000 military retirees, who currently receive annual benefits that average about $10,000 each, would be affected by this change. The following table shows the costs that would result from enactment of Section 203.

(By fiscal year, in millions of dollars)

	1984	1985	1986	1987	1988
Authorization Level	26	60	--	--	--
Outlays	24	60	2	--	--

The costs of this section would fall in all budget functions except 900.

Section 204. This section would remove the cap on maximum leave accumulation for teachers in the Department of Defense Dependent Schools (DoDDS) system. Costs associated with teacher leave result from the hiring of substitutes to replace those teachers on leave. In fiscal year 1984, DoDDS has budgeted $4.6 million for substitute teacher pay. Savings might be expected if those teachers who had accumulated the maximum amount of leave would no longer be placed in a situation where they would choose to take leave during the school year instead of losing it.

A recent comprehensive survey conducted by DoDDS-Germany indicates that only a small portion of the teacher population in that area would be affected by the proposed change in the law. According to the DoDDS survey, which was for the 1982-1983 school year, only 3.8 percent of total teachers had accumulated the maximum amount of leave in Germany. Furthermore, only 16 percent (26 teachers) of those teachers at the maximum level used all of their leave that otherwise would have been lost. CBO has assumed that the results of the DoDDS survey can be applied to the rest of the DoDDS population and therefore any savings would be less than $500,000 per year.

Section 205. This section, if enacted, would have the effect of delaying some payments to the Civil Service Retirement fund for post-1956 military service credit. This proposal would affect mainly military retirees currently employed as federal civilians and participating in the CSR system. The estimate assumes that about 5,000 people would delay contributing on average $6,500 each to the CSR fund for post-1956 military service. After fiscal year 1985, current law, as amended by the Department of Defense Authorization Act of 1984, requires interest payments on these contributions. Enactment of section 205, as shown in the following table, would shift revenues received by the government from 1984 to 1985.

(By fiscal year, in millions of dollars)

	1984	1985	1986	1987	1988
Budget Authority	-30	30	--	--	--
Outlays	--	--	--	--	--
Revenue	-30	30	--	--	--

The changes to budget authority resulting from this section would fall in function 600.

Section 206. This section would make pay increases for all employees of the Panama Canal Commission correspond, in both amount and timing, with pay increases for General Schedule federal employees. Under current law, Commission employees hired after October 1, 1979 are to be given a minimum 2 percent pay adjustment in October of each year. Commission employees hired before October 1, 1979 would receive their 1984 pay adjustment at the same time (January 1984) and in the same amount (3.5 percent under current law; 4.0 percent under the Committee's section 202 proposal) as General Schedule employees. This Committee provision would abolish the current two-tier employee pay schedule that exists for approximately 15 percent of the Commission's employees. It would lower the estimated authorization level for this program and could result in savings as shown in the following table.

(By fiscal year, in millions of dollars)

	1984	1985	1986	1987	1988
Authorization Level	-3	-4	-4	-2	-2
Outlays	-3	-4	-4	-2	-2

The costs of this section would fall in budget function 400.

According to the Panama Canal Commission, however, a 1984 pay adjustment of 2 percent became effective as of October 1983 for Commission employees hired after October 1, 1979. The resulting budgetary effect of this is estimated to be less than $500,000 in 1984-1988, and therefore the savings listed in the latter table would remain unchanged.

6. ESTIMATED COST TO STATE AND LOCAL GOVERNMENTS: None.

7. ESTIMATE COMPARISON:

On October 20, 1983 CBO prepared a revised cost estimate for the reconciliation proposals of the House Committee on Post Office and Civil Service, which differ in major respects from those of the Senate Committee on Governmental Affairs.

8. PREVIOUS CBO ESTIMATE: None.

9. ESTIMATE PREPARED BY: David Bashore (226-2880)
Eugene Bryton (226-2840)
David Delquadro (226-2617)
Julia Doherty (226-2840)
Barbara Hollinshead (226-2840)
Sherri Kaplan (226-2617)
Carmela Pena (226-2820)
Stacey Sheffrin (226-2820)

10. ESTIMATE APPROVED BY:

for James L. Blum
Assistant Director
for Budget Analysis

COMMITTEE ON SMALL BUSINESS

Title III

LOWELL WEICKER, JR., CONN., CHAIRMAN
BOB PACKWOOD, OREG.
ORRIN G. HATCH, UTAH
RUDY BOSCHWITZ, MINN.
BLAIRE KENNON, CALIF.
DAN NICKLES, OKLA.
WARREN RUDMAN, N.H.
ALFONSE M. D'AMATO, N.Y.
BOB KASTEN, WIS.
LARRY PRESSLER, S. DAK.
SAM NUNN, GA.
WALTER D. HUDDLESTON, KY.
DALE BUMPERS, ARK.
JAMES R. SASSER, TENN.
MAX BAUCUS, MONT.
CARL LEVIN, MICH.
PAUL E. TSONGAS, MASS.
ALAN J. DIXON, ILL.
DAVID L. BOREN, OKLA.
ROBERT J. DOTCHIN, STAFF DIRECTOR
R. J. TEMKO, PATTEN, CHIEF COUNSEL
ALAN L. CHVOTKIN, MINORITY CHIEF COUNSEL

United States Senate

COMMITTEE ON SMALL BUSINESS
WASHINGTON, D.C. 20510

September 23, 1983

Honorable Pete V. Domenici
Chairman
Committee on the Budget
U. S. Senate
Washington, D.C. 20510

Dear Mr. Chairman:

In accordance with the reconciliation instruction included in section 3(d) of H. Con.Res. 91, and section 301(b) of the Congressional Budget Act, enclosed are changes in law to achieve cost savings required of this Committee. Also enclosed is report language to accompany the statutory provisions, including the Congressional Budget Office estimate of the savings that these provisions are estimated to achieve.

At a full Committee meeting held September 20, 1983, and with a quorum present, the Committee on Small Business voted unanimously to transmit these provisions. We are advised by the Congressional Budget Office that these statutory provisions meet or exceed the Small Business Committee's instruction for fiscal years 1984-1986.

Sincerely,

SAM NUNN
Ranking Minority Member

LOWELL WEICKER, Jr.
Chairman

Enclosures

I. Summary of Reconciliation Instruction

Section 3(d) of H. Con. Res. 91 provides that:

> (d) The Senate Committee on Small Business shall report changes in laws within the jurisdiction of that committee to require reductions in appropriations for programs authorized by that committee so as to achieve savings in budget authority and outlays as follows: $139,000,000 in budget authority and $287,000,000 in outlays in fiscal year 1984; $555,000,000 in budget authority and $466,000,000 in outlays in fiscal year 1985; and $544,000,000 in budget authority and $443,000,000 in outlays in fiscal year 1986.

In the Conference Report on the First Concurrent Budget Resolution for Fiscal Year 1984, H. Con. Res. 91, adopted by the Senate on June 23, 1983, the Small Business Committee was instructed to report to the Budget Committee by July 22, 1983, its recommendations for changes in law which would result in these budget authority and outlay savings. By unanimous consent, the House and Senate later extended the reporting deadline to September 23, 1983.

The reconciliation instruction given to the Small Business Committee was based on an assumption by the Congressional Budget Office (CBO) that farmers would once again be eligible for assistance under the Small Business Administration (SBA) disaster loan program because of the automatic expiration of amendments to the Small Business Act enacted in 1980 in Public Law 96-302.

The following CBO chart compares the budget authority and outlays that would be needed for the SBA disaster program if farmers were to once again be eligible for disaster aid, and the savings that would result from the adoption of provisions to extend the reforms of Public Law 96-302, restricting their eligibility.

[In millions of dollars]

	FY 1984	FY 1985	FY 1986
Public Law 96-302 Reforms Not Extended			
Budget authority	139	555	555
Outlays	331	534	534
Public Law 96-302 Reforms Extended			
Budget authority	0	0	0
Outlays	44	68	91
Savings			
Budget authority	139	555	555
Outlays	287	466	443

The CBO has advised the Small Business Committee that through the adoption of a provision extending the agricultural disaster lending reforms, the committee has met its reconciliation instruction as mandated by the Congress in H. Con. Res. 91.

II. Committee Considerations

S. 628, a bill to amend section 18(a) of the Small Business Act, was introduced by Senator Weicker on March 1, 1983, and referred to the Small Business Committee.

As introduced, it would make permanent the reforms adopted by Congress in Public Law 96-302. By mandating that farmers go first to the Farmers Home Administration (FmHA) for disaster assistance, so long as the interest rates at SBA and FmHA are "substantially similar," these reforms, for all practical purposes, removed SBA from agricultural disaster lending. These reforms are currently scheduled to expire on October 1, 1983.

At the request of the administration, on May 4, 1983, Senator Weicker introduced another bill, S. 1202, to amend the Small Business Act to totally remove agricultural enterprises from eligibility for assistance under all of SBA's disaster and business loan programs.

On June 8, 1983, the Small Business Committee held a hearing on this legislation. SBA Administrator James C. Sanders and FmHA Administrator Charles W. Shuman presented their views on the bills and their evaluation of their agencies' respective roles in agricultural disaster lending since enactment of the reforms in Public Law 96-302.

On September 20, 1983, the committee met in executive session to consider legislation to meet the savings instruction mandated by the budget resolution.

As the basis for the committee's consideration, Senators Weicker and Nunn proposed that the agricultural disaster lending reforms adopted by Congress in Public Law 96-302 be extended from October 1, 1983, through October 1, 1986.

With a quorum present, the committee unanimously agreed to favorably transmit that recommendation as the means of achieving the reconciliation instruction. Prior to that, the committee rejected, by a vote of 9 to 9, an amendment offered by Senator Baucus to authorize $100 million in direct loans under SBA's nonphysical disaster loan program for small businesses adversely affected by the Government's 1983 payment-in-kind (PIK) program.

The committee-reported provision is as follows:

> Sec. 301. The first sentence of section 18(a) of the Small Business Act is amended by striking "1983" and inserting in lieu thereof "1986".

III. Legislative History

A. HISTORY OF SBA INVOLVEMENT IN FARM DISASTER LENDING

In July 1977, the SBA administratively determined that farmers suffering production crop losses were eligible for SBA disaster loans. At the time this ruling was made, FmHA had already been operating an agricultural disaster loan program for some years. As

a result of this ruling, SBA's disaster loan volume increased from $200 million in 1977 to $2.5 billion in fiscal year 1978, primarily due to crop disaster loans. FmHA disaster loans also rose from $1.2 billion in fiscal year 1977 to $3.4 billion in 1978.

To explain the reasons behind this enormous spending increase, and to provide guidance to Congress in designing a disaster policy that would be both responsive to the needs of agricultural disaster victims and yet fiscally prudent, the General Accounting Office (GAO) was requested to conduct an audit of the fiscal year 1978 operations of the SBA and FmHA programs, and assess whether SBA had administered this program properly.

The GAO report concluded that SBA's staff was inexperienced in agricultural matters and lacked the expertise to properly administer a farm disaster lending program. In contrast, GAO pointed out that FmHA had over 2,300 field offices located throughout the United States whose primary purpose is to assist agricultural enterprises.

The GAO report also noted the fundamental difference between crop losses due to drought, and losses to physical property such as a factory, destroyed in a hurricane or flood. In agriculture, crop yields routinely vary from year to year due to weather conditions or other "ordinary" reasons. The GAO evaluation showed that FmHA took such normal variation into account in determining disaster aid through its requirement that a minimum crop loss be incurred before a farmer is eligible for assistance. The SBA program, however, had no such requirement and treated physical property losses and crop production losses almost identically. Furthermore, FmHA looked at total farm income in computing loan amounts, because, while a farm may have lower-than-normal production in one crop, that could be offset by higher-than-average production in another crop. SBA did not consider this factor when computing losses under its program.

GAO also found that the average size of SBA loans was almost 20 percent greater, and the average maturity about 13 percent longer, than the average FmHA loan. GAO concluded that these differences were due, in part, to less stringent SBA lending requirements.

The GAO auditors also found that the existence of duplicative programs at the two agencies had created opportunities for abuse and fraud. First, loan applicants were able to apply to both agencies and shop for the best or largest loan. Second, and worse, GAO auditors found numerous cases in which applicants fraudulently estimated higher losses and more acres planted when they applied for SBA loans than when they applied for FmHA loans. In addition, GAO uncovered examples of borrowers who fraudulently obtained loans from both SBA and FmHA for the same disaster loss.

GAO concluded that the overall effect was to substantially increase the cost of agricultural disaster lending above what it would have been if FmHA alone had administered the program.

B. PUBLIC LAW 96-302

In 1980, Congress addressed the question of farmer eligibility at SBA through provisions incorporated in Public Law 96-302. The

primary purpose of these reforms was to substantially remove SBA from any significant involvement in agricultural disaster lending, while at the same time ensuring that no agricultural enterprises currently eligible for disaster assistance from the Federal Government would be denied such assistance.

Public Law 96-302 provided that as long as the SBA and FmHA program had "substantially similar" interest rates and terms for disaster assistance, a farmer seeking assistance must have first applied for aid at the FmHA and be declined there before he could be eligible for assistance at SBA under its disaster loan program.

The net result of the reforms adopted in Public Law 96-302 is that SBA has been almost totally removed from farm disaster lending and FmHA has once again assumed primary responsibility for that function.

To ensure that the compromise adopted in 1980 in Public Law 96-302 was not altered, Congress, in the Omnibus Reconciliation Act of 1981 (Public Law 97-35), maintained SBA's disaster interest rates at a level "substantially similar" to the disaster interest rates at FmHA. The Senate and House Small Business and Agriculture Committees coordinated their conference negotiations closely to ensure that comparable proposals would be adopted. Congress acted quickly to ratify this action. Had "substantially similar" interest rates between the two agencies not been maintained, SBA would again have been right back into major farm disaster lending.

C. COMMITTEE HEARINGS

In the last Congress, the committee held hearings on SBA's administration of the farm disaster lending program. The purpose of these hearings was to further examine the extent and gravity of problems encountered during SBA's involvement in agricultural disaster lending, and to determine whether special collection efforts should be instituted to recoup government money which SBA had paid out improperly.

The committee's investigation, which was supported by audits and findings of the SBA Inspector General and the committee's hearings, showed that virtually millions of dollars had been improperly paid out by SBA while administering this program. Some farmers used money earmarked for crop replacement or debt repayment to finance such items as a refurbished home, investments in high-interest bearing certificates of deposits, and other expenses unrelated to farm disaster losses. The Inspector General's audits also showed that some borrowers illegally received duplicate loans and Federal grants from SBA and FmHA for identical losses.

The committee's hearings demonstrated further that these problems occurred in part because of SBA's lack of expertise to administer this specialized program and because borrowers were frequently able to take advantage of the program due to loose administrative and management procedures. The hearings confirmed that a program at SBA which was intended to assist those who suffered very serious and real losses due to extreme weather conditions was abused; that Federal dollars were mishandled; and that during a time of severe budget restraints, the government had the opportunity to collect millions of dollars in misused funds from these bor-

rowers. The hearings also clearly reaffirmed the wisdom of Congress' action in removing SBA from farm disaster lending.

On June 8, 1983, the committee held a hearing on S. 628 and S. 1202. The committee received the views of the administrators of SBA and FmHA on the effectiveness of the reforms in agricultural disaster lending since the enactment of Public Law 96-302 and their assessment of the legislation.

SBA Administrator Sanders acknowledged the vast expertise and resources of the Department of Agriculture in assisting farmers as compared to SBA's limited experience and resources. He further admitted the serious problems encountered when SBA administered its agricultural disaster lending program in the past and conceded that SBA has neither the expertise nor the resources needed to conduct any agricultural-related program. To acquire the expertise would constitute duplication, waste and mismanagement of scarce public resources, he said. As he put it, "I simply believe that SBA should be out of the agricultural lending business entirely. We should leave agricultural lending to the Department of Agriculture."

With respect to disaster loans, Sanders testified that SBA had made two farm disaster loans in the past year. He explained that even with substantially similar interest rates in place at the two agencies, SBA still had the authority to make loans to groups that are, by statutory definition, ineligible at FmHA. These groups include aliens, corporations, partnerships, and cooperatives that are not primarily engaged in farming, and farmers who do not operate their own farms, according to Sanders.

In response to questions from the committee, Sanders also indicated that there have been no complaints from the agricultural community as a result of SBA's withdrawal from agricultural disaster lending. Furthermore, he noted that the agricultural community as a whole expects the Department of Agriculture, not SBA, to provide the services to farmers.

With respect to SBA business loans to agricultural enterprises, Sanders noted that there is a Memorandum of Understanding between SBA and FmHA that sets forth the policy of the two agencies in encouraging agricultural enterprises to first apply to FmHA before coming to SBA for a business loan. As a result, only 20 nondisaster business loans have been made to farmers over the past year, according to Sanders. Sanders concluded that the system currently in place has been effective in controlling the problems of the past, as well as virtually eliminating the duplication of lending activities between the two agencies.

Sanders said it is his feeling that the passage of legislation continuing the 1980 reforms was important to maintaining the efficiency of SBA's operations.

FmHA Administrator Shuman also agreed that the reforms contained in Public Law 96-302, and subsequently reinforced by the Omnibus Reconciliation Act of 1981, were sound and should be continued. He therefore supported passage of the legislation, as well. In doing so, he emphasized that the reforms adopted by Congress "have eliminated a great deal of confusion and public criticism engendered by the old system, under which agricultural enterprises afflicted with weather disaster could shop for loan assistance be-

tween two Federal agencies." He attributed this to each agency using differing criteria to determine what constitutes a disaster, differing loan-making and servicing regulations, and, for a limited time differing interest rates.

In urging the Small Business Committee to maintain the reforms already adopted, Shuman indicated that there are compelling reasons to keep FmHA as the primary Federal lender in the agricultural area. These include:

—A delivery system that serves every rural county through some 2,300 county, district and State offices. Accordingly, no matter where a need arises, a permanent, staffed Farmers Home office is available. In contrast, SBA is organized for different purposes with fewer than 100 offices, and those are located primarily in urban areas;

—Highly trained, qualified personnel at FmHA. The majority of FmHA county supervisors have degrees in agriculture. They are backed by trained farm chiefs in each of 46 State offices, and a section of the national office specifically responsible for farm emergency loans; and

—Expertise in the determination of losses. Since the 1970's, when the disaster program underwent a rapid rise in lending, and since September 26, 1980, when a Memorandum of Understanding between FmHA and SBA delineated the current system, numerous changes have been made to strengthen the designation process. It now starts at the county level with close cooperation between FmHA and the Agricultural Stabilization and Conservation Service (ASCS), which maintains the historic crop yield records necessary to determine the extent of damage and eligibility for aid. The existing FmHA–ASCS system uses permanent, on-site agricultural personnel and offices, very often sharing space in the same location.

Both Shuman and Sanders agreed that the current statutory provisions governing farmer eligibility for farm-disaster-related aid, and the relationship between SBA and FmHA, are not only working but working well.

D. NONPHYSICAL DISASTER LOAN PROGRAM AMENDMENT

During the September 20, 1983, Small Business Committee markup, Senator Baucus offered an amendment that would have reactivated SBA's nonphysical disaster lending program for fiscal year 1983 only. It specifically provided that those businesses adversely affected by the Department of Agriculture's payment-in-kind (PIK) program would be deemed to have suffered injury "as a consequence of government action" and therefore would be eligible for SBA loan assistance. This amendment would also have placed a $100 million cap on the program and would have provided loans to qualified applicants at a maximum maturity of 3 years. The amendment also provided the necessary authorizations for fiscal year 1984 only (beginning on October 1), but permitted the $100 million to be available without fiscal year limitation. By a vote of 9 to 9 the committee rejected this amendment.

Eligibility for this nonphysical disaster program had some further limitations. First of all, there must have been a direct causal relationship between the governmental action and the loss suffered. The potential borrower would have had to prove that the loss was the result of this action. Finally, the potential borrower would have had to prove that the loss was not covered by insurance and that he was not able to obtain credit elsewhere to assist in recovering from the loss.

Senator Baucus noted that the impact of PIK on agricultural support industries was reviewed at length at hearings held by the committee on June 9, 1983, and that there was a need for assistance to be made available to these businesses. In addition, Senator Baucus noted that, to the extent that businesses adversely affected by the PIK program had the financial strength to borrow commercially, even with the SBA guarantee, that would be preferable under the amendment. By statutory definition, assistance under the SBA nonphysical disaster program would be available only to those borrowers "unable to get credit elsewhere." Thus, the assistance would be a source of last resort for borrowers adversely affected by PIK and not able to use the FmHA, or the SBA guaranteed loan programs.

In arguing against this amendment, the chairman noted that in the Reconciliation Act of 1981, the committee specifically eliminated funding for SBA's nonphysical disaster loan program. The adoption of the Baucus amendment would reverse this policy and perhaps open the nonphysical disaster loan program to other demands from small businesses suffering from similar problems.

The CBO has conservatively estimated the potential demand for this program to be over $1.5 billion. SBA representatives stated their objection to the creation of such a program, contending that it would place a substantial administrative burden on the agency because of the allocation of so little money for so many prospective applicants.

SBA officials also pointed out that they have increased efforts to provide sufficient resources to small business borrowers adversely affected by the PIK program through the agency's regular guaranteed business lending program. They advised the committee that these efforts will continue in cooperation with the Department of Agriculture.

Questions were also raised about the feasibility of determining the causal relationship between the governmental action and the farmer's loss. Witnesses suggested that in many instances, it could be difficult for SBA to draw the distinction between losses caused by PIK and those brought about by other factors such as drought.

Finally, if adopted, this amendment would have required the committee to report out concurrent reductions in the SBA direct business loan program. In a recently approved authorization bill (S. 1323) for SBA, the committee eliminated the direct business loan programs except for assistance to handicapped, veterans, and minority enterprise small business investment companies. The adoption of the Baucus amendment would have forced the committee to make additional cuts in direct lending beyond those already approved in that bill.

IV. Section-by-Section Analysis

The Small Business Committee provision amends section 18(a) of the Small Business Act to extend from October 1, 1983, through October 1, 1986, reforms adopted by Congress in 1980 to substantially remove the Small Business Administration from agricultural disaster lending.

V. Matters To Be Discussed Under Senate Rules

A. COMMITTEE VOTE

In compliance with rule XXVI(7)(B) of the Standing Rules of the Senate, the following rollcall votes were recorded:

On the motion to adopt the Baucus amendment to authorize $100 million in direct loans under SBA's nonphysical disaster loan program for small businesses adversely affected by the Government's fiscal year 1983 payment-in-kind program:

YEAS	NAYS
Nunn	Packwood*
Huddleston*	Hatch*
Bumpers*	Boschwitz*
Sasser*	Gorton*
Baucus	Nickles*
Levin	Rudman*
Tsongas*	D'Amato*
Dixon	Kasten*
Boren*	Weicker

*Indicates a vote by proxy.

By voice vote and with a quorum present, the motion to favorably report to the Budget Committee the provision extending the reforms adopted in Public Law 96-302, through October 1, 1986, was agreed to.

B. COST OF LEGISLATION

In compliance with rule XXVI of the Standing Rules of the Senate, the Small Business Committee estimates that the savings resulting from this legislation will be equal to the amounts indicated by the Congressional Budget Office in the attached letter.

CONGRESSIONAL BUDGET OFFICE
U.S. CONGRESS
WASHINGTON, D.C. 20515

Rudolph G. Penner
Director

September 22, 1983

Honorable Lowell P. Weicker, Jr.
Chairman
Committee on Small Business
United States Senate
428A Russell Senate Office Building
Washington, D.C. 20510

Dear Mr. Chairman:

Pursuant to Section 403 of the Congressional Budget Act of 1974, the Congressional Budget Office has prepared the attached cost estimate for S. 628, a bill that amends the Small Business Act and that includes the Committee's recommendations for reconciliation pursuant to the First Concurrent Resolution for fiscal year 1984.

Should the Committee so desire, we would be pleased to provide further details on this estimate.

Sincerely,

R. G. Penner

Rudolph G. Penner
Director

cc: Honorable Sam Nunn
Ranking Minority Member

CONGRESSIONAL BUDGET OFFICE

COST ESTIMATE

September 22, 1983

1. BILL NUMBER: S. 628

2. BILL TITLE: A bill to amend the Small Business Act

3. BILL STATUS:

As ordered reported by the Senate Committee on Small Business, September 20, 1983.

4. BILL PURPOSE:

This bill would amend the Small Business Act to modify the operation and administration of the Small Business Administration's disaster loan revolving fund by extending provisions of existing law that require farm borrowers to seek farm disaster loans from the Farmers Home Administration (FmHA) before they can apply for similar assistance from the SBA. Those provisions, due to expire on September 30, 1983, would be extended to September 30, 1986.

5. ESTIMATED COST TO THE FEDERAL GOVERNMENT:

(by fiscal years, in millions of dollars)

	1984	1985	1986	1987	1988
Authorization Level	-139	-355	-344	-41	142
Estimated Outlays	-287	-466	-443	-66	137

The costs of this bill fall within budget function 450.

Basis of Estimate:

The savings that would result from enactment of this bill have been estimated by calculating the net impact of the change made by the bill on the operations of the disaster loan revolving fund.

For the purposes of this estimate, this change has been evaluated relative to a base disaster loan program as it would be expected to operate if there was no change to existing laws and operating regulations.

6. ESTIMATED COST TO STATE AND LOCAL GOVERNMENTS: None.

7. ESTIMATE COMPARISON: None.

8. PREVIOUS CBO ESTIMATE:

On September 22, 1983, the Congressional Budget Office prepared a cost estimate for a similar bill, as ordered reported by the House Committee on Small Business on July 21, 1983. That bill included a provision identical to the extension included in this bill.

The House bill, however, made additional changes to the Small Business Act. Under provisions in the House bill, SBA's lending authority for physical disaster loans would be limited to $500 million in fiscal years 1984 through 1986, and they would be authorized to make $100 million in nonphysical disaster loans in those years. Businesses adversely affected by currency fluctuations and exchange freezes and businesses that experienced economic injury resulting from the government's payment-in-kind (PIK) program would be eligible for nonphysical loans. The House bill also changed the manner of determining loan interest rates for SBA disaster loan programs.

9. ESTIMATE PREPARED BY: Linwood T. Lloyd (226-2860)

10. ESTIMATE APPROVED BY:

for C. G. Nuckols
James L. Blum
Assistant Director
for Budget Analysis

C. REGULATORY IMPACT STATEMENT

In compliance with rule XXVI(11)(b) of the Standing Rules of the Senate, it is the Small Business Committee's belief that this legislation will have no regulatory or privacy impact on the small businesses affected by the legislation.

VI. CHANGES IN EXISTING LAW

In compliance with rule XXVI(12) of the Standing Rules of the Senate, changes in existing law made by the statutory provisions of this legislation are as follows (existing law proposed to be omitted is enclosed in black brackets, new material is printed in italic, and existing law in which no change is proposed is shown in roman):

SMALL BUSINESS ACT

* * * * * * *

"SEC. 18(a). The Administration shall not duplicate the work or activity of any other department or agency of the Federal Government, except to those enterprises engaged in the production of food and fiber, ranching, and raising of livestock, aquaculture, and all other farming and agricultural related industries: *Provided,* that prior to October 1, [1983] *1986,* an agricultural enterprise shall not be eligible for loan assistance under paragraph (1) of section 7(b) to repair or replace property other than residences and/or personal property unless it is declined for, or would be declined for, emergency loan assistance at substantially similar interest rates from the Farmers Home Administration under subchapter III of the Consolidated Farm and Rural Development Act, and nothing contained in this act shall be construed to authorize any such duplication unless such work or activity is expressly provided for in this act. If loan applications are being refused or loans denied by such other department or agency responsible for such work or activity due to administrative withholding from obligation or withholding from apportionment, or due to administratively declared moratorium, then, for purposes of this section, no duplication shall be deemed to have occurred."

25-551 O—83——14

ADDITIONAL VIEWS OF SENATORS HUDDLESTON, SASSER, AND BAUCUS

FARM DISASTER LENDING

INTRODUCTION

In 1980 Congress and the executive branch reached a compromise on the disaster assistance program for farmers. The compromise was designed to assure that farmers are provided necessary and adequate disaster assistance in a fair and consistent manner. The Senate Small Business Committee has acted to extend this program for another 3 years. Although this indicates a desire to continue the previous program, I do not think that it should be interpreted as a blanket endorsement of the way the program is being adminstered. In fact, there are strong indications that the implementation of the program may be moving away from the original intent of Congress. In order to assure that the record of this program is complete and accurate, I believe that all pertinent information should be presented.

BACKGROUND ON 1980 LEGISLATIVE CHANGES

In 1977, during a hearing in the Senate Small Business Committee, SBA's General Counsel acknowledged that a "drought" was a "disaster" under the terms of the Small Business Act. Almost immediately thereafter, farmers began applying to the Small Business Adminstration for disaster assistance because of the almost unprecedented droughts that affected parts of the country. In retrospect, it appears that SBA was inundated with applications because it had more favorable rates and terms than the Farmers Home Administration at that time, SBA did not have as cumbersome a field review process, SBA did not impose any minimum crop production loss criteria, and SBA had a little easier collateral requirement. The result of these more lenient provisions put SBA into farm disaster lending, primarily for drought crop production loss, to the tune of almost $2 billion in each of fiscal years 1977, 1978 and 1979.

Congress and the Carter administration shared a deep concern about the fiscal impact of farmer eligibility at SBA. In fact, the Carter administration had proposed that farmers be excluded totally from SBA disaster assistance lending, and this proposal was rejected. However, despite the need to correct the imbalance between the two agencies' programs, Congress felt that SBA should not totally be removed from a residual, contingent role in providing disaster assistance to farmers.

From this "philosophy" came the 1980 farm disaster provisions. Basically, those statutory requirements state that a farmer must first seek disaster assistance from the Farmers Home Administration, and "be declined for, or would be declined for" emergency

loan assistance from FmHA "at substantially similar" interest rates.

Members on both sides of the aisle, in both Houses of Congress, and in the administration, believed that these provisions would substantially reduce the amount of SBA crop disaster lending at SBA. Yet there was a clear recognition that SBA would still be doing some lending to farmers who would not receive disaster assistance from Farmers Home.

This 1980 formulation and legislative intent was reinforced during the 1981 Reconciliation Act. The Senate sought to strengthen the 1980 provisions; the House made no change to existing law. The conferees left existing law, but made it clear in the statement of managers in the conference report that:

> The conferees expect the Administrator of SBA and the Secretary of Agriculture to consult and establish substantially similar interest rates for creditworthy and noncreditworthy borrowers. Statutory language approved by the conferees conforms to that adopted by the Agriculture Committee conferees with respect to interest rates for disaster assistance from Farmers Home Administration. This was done to insure that farmers must seek disaster assistance first from FmHA pursuant to Public Law 96-302.

On June 8, the Senate Small Business Committee held a hearing on legislation pending before the committee that would continue the 1980 legislative provisions regarding farm disaster lending. As the committee report notes, at that hearing the committee again reviewed a GAO report, and the committee's previous investigations of the duplication between the SBA and FmHA disaster programs.

As a followup to the committee's June 8 hearing relating to farm disaster eligibility, questions were submitted to the Small Business Administration and the Farmers Home Administration. The primary focus of these questions related to the operation of the 1980 disaster eligibility provisions, and the extent to which there is any "farm disaster lending" taking place at SBA after the July 2, 1980, date on which the "substantially similar interest rate" provisions took effect.

PROGRAM OPERATION TO DATE

According to a June 3, 1983, letter to Senator Nunn, the committee's ranking member, from House Small Business Committee Chairman Parren Mitchell, an extensive search done by the House staff found only 19 crop production loss loans made by SBA for disasters which commenced after July 2, 1980. Given the nature of the SBA data from which that staff worked, it is conceivable that there are additional crop disaster loans that have been made, but miscoded by the agency. However, the magnitude of SBA's farm disaster lending would not significantly change.

In response to the questions for the record, SBA acknowledged that they have made no crop-related disaster declarations for disasters which commenced after July 2, 1980, although there is clear authority in law for them to do so. The Farmers Home Administra-

tion indicated that they have made 419 declarations for crop-related disasters commencing after July 2, 1980.

Farmers Home indicates that over 190,000 farmers have received emergency loan assistance from them from July 3, 1980, through June 17, 1983. During that same period of time, over 20,000 applicants were denied assistance from the Farmers Home Administration.

In their testimony before the Small Business Committee on June 8, SBA acknowledges that they have made individual crop disaster loans since July 2, 1980, but virtually all for disasters which commenced before that July 2, 1980, date. Beyond crop disaster loans, SBA stated in response to questions that they have made a total of 165 nondisaster business loans to farmers in fiscal year 1981, a total of 22 nondisaster business loans to farmers in fiscal year 1982, and a total of 21 nondisaster business loans to farmers in the first 6 months of fiscal year 1983.

SBA/FMHA APPLICATION REFERRAL PROCESS

In response to questions for the record, the Farmers Home Administration stated that the following applicants would not be eligible at FmHA for their emergency loan assistance:

—noncitizens;

—corporations, cooperatives, or partnerships not primarily engaged in farming; and

—farm owners who do not operate their farms.

All of these applicants are ineligible by law for assistance at FmHA and, according to FmHA, would be automatically referred to SBA.

Those "ineligible" borrowers who do not "possess repayment ability or have sustained disaster loss insufficient to meet minimum loss criteria," however, are NOT referred by FmHA to SBA for SBA's review, according to Farmers Home. Regrettably, the questions did not ask FmHA for a breakdown of the number of applicants that were determined to be statutorily ineligible.

However, Farmers Home was asked for the number of referrals that were made to SBA. While they indicated that they do not keep records of referrals, they said that their county office personnel are familiar with the referral process and "would have referred those ineligible applicants who are outlined (above)" to SBA. SBA was asked for the number of referrals received from FmHA, but they indicated that they do not keep records of referrals received from FmHA.

An informal poll conducted by the Democratic staff of the Senate Small Business Committee of all four SBA disaster processing offices indicated that, in this fiscal year, through June 30, disaster office No. 1 has received only one referral from FmHA, and that resulted in an application for disaster assistance being submitted; disaster office No. 2 received no referrals from FmHA; disaster office No. 3 received two referrals which resulted in two applications being submitted; and disaster office No. 4 received no referrals. These three applications resulted in two SBA loans, according to the agency, a fact confirmed by SBA Administrator Sanders in

his testimony before the Senate Small Business Committee on June 8, 1983.

SBA CROP RELATED DISASTER DECLARATIONS

Another troubling aspect of the farm disaster lending program is SBA's response to the questions about authority to provide disaster assistance. SBA acknowledged that, except in only a very few isolated instances, there is no eligibility at SBA for disaster assistance without a disaster "declaration" by SBA. SBA has the legal authority to make a declaration for drought-related disaster under present law. SBA has not made a single disaster declaration for crop related damage that has occurred since July 3, 1980. Furthermore, their May 27 proposed revisions to their disaster regulations would, if adopted in their present form, eliminate "drought" as a legitimate basis for a future SBA disaster declaration.

SBA DISASTER DECLARATION THRESHOLDS

In addition to these provisions, the SBA's May 27 proposed revisions to their disaster regulations may further limit everyone's access to SBA's disaster assistance program. For example, for agriculture lending specifically, the agency intends to determine the amount of loss based on "cash outlay production loss" rather than on "prior year's market prices." If carried through into the final regulations, this single provision will mean that a farmer could get back the actual cost of seed, fertilizer, and fuel for farm equipment, but get no credit for growing the crops. SBA acknowledges in their regulations that "the purpose of the formula is to restrict compensation" and that "SBA contemplates that this formula will not often be used since under present law farm losses are to be compensated by SBA only if not compensable by FmHA."

In addition, for the first time, SBA's regulations will specify a "minimum loss" criteria for eligibility, to be set at "substantially similar" to that imposed by FmHA.

The SBA proposed regulations also increase the minimum threshold of loss before the agency will consider making any nonfarm disaster declarations, including increasing the number of businesses affected and/or the percentage of loss sustained.

CONCLUSION

Based on the record established at the Small Business Committee's hearings, and our brief review of the operation of the farm disaster lending operation since July 3, 1980, there are strong indications that the statute and congressional intent may not be fully complied with. SBA and FmHA clearly have designed a program to minimize duplication of effort, and the potential for duplication of benefits by farm businesses. But in the process, they have virtually shut farmers out at SBA for assistance, and have designed a programmatic scheme to keep farmers out totally and to significantly reduce everyone's access to the SBA disaster program.

There appears to have been few complaints about the agencies' current relationship, which may indicate that the farm business community is satisfied with the present system. It is equally plausi-

ble to conclude that the joint operation of the program by the two agencies submerges the potential for a review of eligibility by the SBA of FmHA denials and farmers are not aware of their options. The two agencies are clearly not informing farmers who have been denied assistance at FmHA for reasons other than statutory eligibility that there is an option of seeking an additional review at SBA.

No member is suggesting that SBA should resume a primary lending responsibility for farm disaster loans, nor has it been suggested that the statute be reopened for substantive amendment at this time. However, the information that has been developed does raise questions in our minds about the implementation of the 1980 farm disaster provisions by SBA and FmHA.

We believe the best way to resolve these and other questions which have been raised about the administration of the disaster assistance program is for the Small Business Committee to expeditiously undertake an aggressive oversight review of the entire system.

WALTER HUDDLESTON.
JIM SASSER.
MAX BAUCUS.

ADDITIONAL VIEWS OF SENATOR MAX BAUCUS

During the Small Business Committee's executive session to consider legislation necessary to meet the savings mandated under the fiscal year 1984 First Concurrent Resolution on the Budget, I offered an amendment that would have provided some necessary assistance to the "farm input" businesses that have been so seriously and adversely affected by the administration's 1983 payment-in-kind (PIK) land diversion program. The amendment failed on a tie vote of 9 to 9. I believe that the injury that has been suffered by so many of these small business firms across the country merits the temporary, and limited financial assistance from the Federal Government that my amendment would provide.

BACKGROUND ON THE SBA DISASTER LOAN PROGRAM

Under prior law, there were seven separate programs Congress had created that permitted eligibility for disaster assistance from SBA even though there had been no physical disaster. Many of these so-called "nonphysical" disaster provisions dealt in some form with disaster eligibility caused by Government action. In 1981, Congress combined these seven separate disaster programs into a single disaster program, the so-called 7(b)(3) loan program after that section of the Small Business Act in which the authority is contained.

Eligibility for this nonphysical disaster program has some limitations. First of all, there must be a direct causal relationship between the governmental action and the loss. The potential borrower must prove that the loss was the result of this action. Finally, the potential borrower must prove that the loss is not covered by insurance and that he is not able to obtain credit elsewhere to assist in recovering from the loss. If these criteria are met, the borrower is eligible for a disaster loan from SBA, with a maximum maturity of 30 years, and at an interest rate of 8 percent.

In 1981, during consideration of the Omnibus Reconciliation Act of that year, the Small Business Committee was given an instruction to save a considerable amount of money. The largest discretionary source of funds available to the committee then, as now, is in the area of disaster assistance. As part of a wide range of changes to the SBA disaster assistance provisions, the committee proposed, and ultimately the Congress agreed, to specifically deny the authorization for appropriations for the SBA "nonphysical" disaster program through fiscal year 1984.

SPECIFICS OF BAUCUS AMENDMENT

My amendment provides that loss suffered by small business concerns as a result of the 1983 PIK program occurred as a direct consequence of Government action. In addition, the amendment would:

—provide that eligibility would be for loss suffered as a result of the 1983 PIK program only;

—be limited to the statutory maximum of $500,000 per loan;

—require that the loan maturity shall not exceed 3 years; and

—provide that the maximum amount to be authorized for assistance will be $100 million.

The amendment also provides the necessary authorizations for fiscal year 1984 only (beginning on October 1), but permits that $100 million to be available without fiscal year limitation.

SMALL BUSINESS COMMITTEE HEARINGS HAVE PROVEN THE NEED FOR HELP

On June 9, the Senate Small Business Committee's Family Farm Subcommittee held a hearing on the impact of the payment-in-kind program on agricultural support industries. Under the leadership of the subcommittee chairman, Senator Pressler, the committee received testimony from seed and fertilizer dealers, from equipment manufacturers and from administration officials. I was pleased to participate in that hearing. I believe it was clear from the testimony that there is a major crisis in the support industries that was created by the administration's sudden announcement of the PIK program. Seed dealers that had made commitments months earlier were caught with huge inventories; fertilizer dealers were unable to find buyers for their products.

I believe one quote from the hearing sums up the problems that PIK created for these industries:

> (W)e know that repairs (of farm machinery) are going to be way down. We estimate that they will be off somewhere in the neighborhood of 12 to 15 percent. We expect the use of pesticides to drop somewhere in the neighborhood of 13 to 17 percent . . . Seed producers and retailers are going to be hurt substantially. In the case of seed corn, . . . there are also some small companies. Those small companies are having a difficult time. In the energy area, we are expecting use to drop about a tenth overall. The biggest impact will be in the liquid fuel area. Here use will be down somewhere from 25 to 30 percent

The witness was a representative of the Department of Agriculture.

THE AMENDMENT WILL PROVIDE NECESSARY ASSISTANCE

The form of assistance provided would be in a direct loan from SBA to the eligible business. However, *all* disaster assistance takes this form, regardless of whether it is from a flood or hurricane, or from the eligibility that this amendment would establish for PIK. In fact, SBA has recently amended its regulations to *eliminate* "guarantees" as a basis for disaster lending because all of the loans made are direct loans. In fiscal year 1983, through August 31, 1983, SBA has already made a total of $182.5 million in direct disaster loans to needy borrowers. But these disaster loans should not be confused with the Small Business Administration's regular busi-

ness loan program which has both a "direct" and a "guaranteed" component to it.

SBA has "announced" that they have given instructions to their field offices to be sensitive to the needs of the small businesses adversely affected by PIK, and try to use the SBA guaranteed loans to assist them. Farmers Home has put out similar instructions to its offices. The SBA guaranteed business loans are all channelled through financial institutions at market rates plus a premium. To the extent that the business adversely affected by the PIK program has the financial strength to borrow commercially, even with the SBA guarantee, this would be preferable. In fact, by statutory definition, assistance under the SBA nonphysical disaster program that would be reestablished by my amendment is available only to those borrowers "unable to get credit elsewhere." This assistance would be a source of last resort for borrowers who have been adversely affected by PIK and are not able to use the FmHA or the SBA guaranteed loan program. A requirement that a borrower first seek out and be denied those other programs could easily have been added without affecting the operation of the amendment if this clarification would ease the concern that the program being established duplicates the work of other programs or agencies.

CBO has "conservatively" estimated that the total loss to the small input dealers has been at least $1.5 billion. The $100 million cap which I had included in the amendment was the maximum amount that could be made available for this program under the strict procedural controls that the committee operated under in meeting reconciliation, and the maximum amount that was within the jurisdiction of the committee that could be used to offset the cost of the amendment. While I recognize that this amount will not be sufficient to meet the entire demand, it will provide a significant measure of assistance to that segment of the small business community that has been directly, significantly, and immediately affected by the Government's action in the PIK program, and are least able to withstand that impact.

Secondly, the total funding needs are unclear. As was indicated earlier, the SBA nonphysical disaster program will be available only for those businesses unable to get credit elsewhere. Of the $1.5 billion in potential liability, many businesses are, or have already, covered part of their loss through private borrowing; they will likely not receive assistance under the Baucus amendment. For those businesses able to get assistance from Farmers Home, or the SBA guaranteed loan program, and I would encourage businesses to seek out that assistance, they would not be eligible under the Baucus amendment. Businesses that suffered loss, but who are unable to show a repayment ability within the 3-year limit of the amendment would not be eligible under the Baucus amendment. So it is possible that the $1.5 billion in potential liability could shrink to some much lower universe of eligibility such that this $100 million could have a significant positive benefit on a large segment of those in need.

SBA has argued that the amendment would be an administrative nightmare for the agency to handle, in part because of the difficulty in proving losses directly traceable to PIK, and in part because of the difficulty in "allocating" funds. However, the requirement

for proof of loss rests completely with the potential borrower, not with the agency. The agency already has an "economic injury" loan program, and this element of proof has always been there; somehow the agency has survived. For example, on August 18 SBA announced the availability of this economic loss disaster program for garment businesses in New York City affected by the August blackout. The interest rate is 8 percent. How difficult will it be to prove loss from the blackout? For those businesses in the garment industry, maybe as difficult as it would be for those agriculture related small businesses affected by PIK.

With respect to the issue of the "allocation" of funds that would be made available under this amendment, I would envision that the funds would be distributed to those eligible borrowers in the same manner as the agency allocates funds under the regular disaster loan program, or under the agency's regular direct business loan program, that is, on a first-come, first-served, basis. Given the widespread geographic distribution of loss, if there is a concern about that allocation, I see no reason why the applications approved in each disaster office could not be numerically ranked based on time of approval nationwide, and allocated in that manner on a first approval basis.

CONCLUSION

The tie vote in committee on my amendment demonstrates that there is a clear recognition in Congress of the problems that the PIK program has caused the agricultural support industries. I believe the amendment is meritorious, and will be of significant benefit to those businesses in need. During the next several weeks, I will be monitoring the efforts of the Small Business Administration and the Farmers Home Administration to determine the extent of assistance they are providing to these businesses. In addition, I will be exploring the alternatives available to those of us who support providing this limited, temporary assistance to these small businesses.

MAX BAUCUS.

COMMITTEE ON VETERANS' AFFAIRS

Title IV

ALAN K. SIMPSON, WYO., CHAIRMAN
STROM THURMOND, S.C.
ROBERT T. STAFFORD, VT.
FRANK H. MURKOWSKI, ALASKA
ARLEN SPECTER, PA.
JEREMIAH DENTON, ALA.
RUDY BOSCHWITZ, MINN.
ALAN CRANSTON, CALIF.
JENNINGS RANDOLPH, W. VA.
SPARK M. MATSUNAGA, HAWAII
DENNIS DE CONCINI, ARIZ.
GEORGE J. MITCHELL, MAINE

United States Senate
COMMITTEE ON VETERANS' AFFAIRS
WASHINGTON, D.C. 20510

August 25, 1983

Honorable Pete V. Domenici
Chairman
Honorable Lawton Chiles
Ranking Minority Member
Committee on the Budget
United States Senate
Washington, D. C. 20510

Dear Pete and Lawton:

Pursuant to the reconciliation instruction in section 3(e) of the First Concurrent Resolution on the Budget for Fiscal Year 1984 (H. Con. Res. 91), the Committee on Veterans' Affairs by unanimous vote at a July 21, 1983, meeting ordered the enclosed legislative provisions to be reported to the Committee on the Budget for incorporation in a reconciliation bill for fiscal year 1984. Report language to accompany these provisions is attached to them.

Also enclosed is a Congressional Budget Office (CBO) estimate of the savings that these provisions are estimated to achieve, in fiscal years 1984 through 1988, from the baseline figures for entitlement programs under our Committee's jurisdiction. Those estimated savings for fiscal years 1984 through 1986 are in the amounts required by the reconciliation instructions to our Committee: $228 million in budget authority and $226 million in outlays in fiscal 1984; $139 million in budget authority and $138 million in outlays in fiscal year 1985; and $141 million in budget authority and $140 million in outlays in fiscal year 1986.

We would note that the enclosed provisions fully conform to the description of provisions we discussed with both of you in a May 19, 1983, colloquy, and which you agreed at that time would constitute compliance with the reconciliation instruction to our Committee.

We further note, with respect to fiscal year 1984, that on July 21 our Committee ordered reported a 3.5-percent increase in Veterans' Administration compensation benefits, effective April 1, 1984, which is estimated by CBO to achieve the requisite savings for that year.

With warm regards,

Cordially,

Alan K. Simpson
Chairman

Alan Cranston
Ranking Minority Member

Enclosures

BEST COPY AVAILABLE

TITLE IV—BUDGET RECONCILIATION RECOMMENDATIONS OF THE COMMITTEE ON VETERANS' AFFAIRS PURSUANT TO H. CON. RES. 91

INTRODUCTION

The Senate Committee on Veterans' Affairs has been instructed by the Congress, in section 3(e) of House Concurrent Resolution 91, the First Concurrent Resolution on the Budget for Fiscal Year 1984, to submit to the Senate Committee on the Budget recommendations for changes in laws within the jurisdiction of the Committee on Veterans' Affairs which provide spending authority as defined in section 401(c)(2)(C) of the Congressional Budget Act of 1974 sufficient to reduce budget authority by $228 million and outlays by $226 million in fiscal year 1984; to reduce budget authority by $139 million and outlays by $138 million in fiscal year 1985; and to reduce budget authority by $141 million and outlays by $140 million in fiscal year 1986.

On February 16, 1983, in preparation for the submission of this committee's views and estimates on the fiscal year 1984 budget for programs within its jurisdiction, this committee held a hearing on issues concerning the fiscal year 1984 budget for veterans' programs. Several cost-saving measures were considered by the committee at that hearing, including the Administration's proposal to delay by 6 months—from October 1, 1983, the date which would conform to established congressional practice, to April 1, 1984—the effective date of the fiscal year 1984 cost-of-living adjustment (COLA) in the rates of compensation paid to service-connected disabled veterans and dependency and indemnity compensation (DIC) paid to the survivors of those who have died from service-connected disabilities. At a July 21, 1983, meeting, the committee voted unanimously to recommend, and to submit to the Budget Committee for inclusion in a reconciliation bill, legislative provisions to achieve the requisite cost savings as discussed below.

DISCUSSION

Effective dates of compensation and DIC increases

Section 401(a) would prohibit the enactment of fiscal year 1984 increases in compensation and DIC rates that would cost in excess of $175.5 million in budget authority or $145.3 million in outlays. As compared to the Congressional Budget Office (CBO) estimated baseline costs of the compensation and DIC programs (which include the costs of the benefit payments under current law plus annual rate increases, effective October 1 of each year, to keep pace with inflation), this limitation would, according to CBO, produce the requisite amount of fiscal year 1984 savings—$228 million in budget authority and $226 million in outlays. It is understood that reconciliation savings are to be measured against the baseline estimates.

CBO's estimate of the baseline costs of the compensation and DIC programs in fiscal year 1984 includes the cost of a 4.1-percent compensation/DIC COLA effective October 1, 1983—$403.5 million in budget authority and $371.3 million in outlays in fiscal year 1984.

BEST COPY AVAILABLE

This baseline estimate comports with well-established congressional practice. In each of the last 7 years, the Congress has enacted COLA's, effective October 1 of each year, in the rates of compensation and DIC. Such annual adjustments protect these most deserving beneficiaries from a loss of value in their benefit payments due to inflation. In this regard, it is the policy of the Senate Veterans' Affairs Committee to recommend that the percentage increase in compensation and DIC rates be at least equal to the percentage increase that social security beneficiaries receive in the same calendar year. (Veterans' Administration non-service-connected disability and death pension rates are by law, in section 3112 of title 38, United States Code, automatically increased each year by the same percentage and on the same date as social security old age, survivors', and disability benefits.)

The Veterans' Affairs Committee, in its March 1983 report of its fiscal year 1984 budget views and estimates (Senate Print 98–44), stated:

> In view of the bipartisan Social Security Commission's plan to achieve much needed cost savings in social security expenditures by delaying the effective date of the 1983 cost-of-living adjustment by 6 months, and the Administration's corollary proposal to delay cost-of-living adjustments for all other Federal entitlement programs, the committee recommends, contingently, [that] amounts allowed for the fiscal year 1984 compensation and DIC cost-of-living increases be limited to the amounts necessary for increases at the same percentage as the social security percentage increase and effective April 1, 1984, which is 6 months later than the effective date (October 1, 1983) Congress would ordinarily enact for those increases. As previously noted, according to CBO, that percentage increase will be 4.1 percent, and the cost of a 4.1-percent increase effective April 1, 1984, would be $201 million in budget authority and $171 million in outlays in fiscal year 1984.
>
> * * * * *
>
> The committee reiterates its strong belief that benefits for service-connected disabled veterans are and should continue to be the highest priority mission of the VA. It is the committee's view that only if social security and all other Federal income-maintenance programs experience a delay in cost-of-living adjustments would limit[ing] the amount provided for the compensation and DIC increases in the manner discussed above be appropriate.

Subsequently, COLA's for Social Security Act-indexed programs were permanently delayed by 6 months—from June 1 to December 1 of each year (beginning in 1983)—through the enactment on April 20 of section 111 of the Social Security Amendments Act of 1983 (Public Law 98–21).

With the committee's stated contingency having thus been met, its recommendation regarding the delay of the fiscal year 1984 compensation/DIC COLA became noncontingent.

Also subsequent to the committee's March budget recommendations, the actual percentage of the social security COLA in calendar year 1983 was computed as 3.5 percent—not the 4.1 percent that CBO was projecting as of the time that the committee submitted its March report and that was assumed for purposes of computing the baseline.

Thus, on July 21, the committee—consistent with its earlier recommendations and with the delay in and percentage of this year's social security COLA—ordered favorably reported a 3.5-percent compensation/DIC COLA, to take effect on April 1, 1984. The proposed COLA will be set forth in part A of title I of S. 1388 as ordered reported by the committee, the proposed "Veterans' Compensation and Program Improvement Amendments of 1983." The fiscal year 1984 cost of this legislation is, according to CBO, $175.5 million in budget authority and $145.3 million in outlays, the amounts to which the provision (section 401(a)) that our committee is submitting would limit the COLA. These amounts are also, of course, $228 million in budget authority and $226 million in outlays less than the amounts included in the baseline estimates for the compensation/DIC COLA.

With respect to fiscal years 1985 and 1986, the enactment of a 3.5-percent COLA—in lieu of the 4.1-percent COLA assumed for purposes of baseline computations—would, according to CBO, achieve savings of $61 million in both budget authority and outlays in fiscal year 1985 and $63 million in budget authority and $62 million in outlays in fiscal year 1986.

Section 401(b), would prohibit the enactment of fiscal year 1985 and 1986 compensation/DIC COLA's with effective dates earlier than December 1, 1984, and December 1, 1985, respectively.

The committee notes that this provision would preclude compensation/DIC COLA's from taking effect earlier than the date on which social security and VA non-service-connected pension COLA's will take effect under section 111 of Public Law 98-21.

The committee also notes that, in section 107 of S. 1388 as ordered reported, it has recommended a provision to express the sense of the Congress that compensation/DIC COLA's enacted to take effect in fiscal year 1985 and subsequent fiscal years shall take effect *on* December 1 of the fiscal year involved—rather than simply not earlier than December 1—and that the budgets for those years should include amounts to provide COLA's effective December 1.

The proposed reconciliation provision (section 401(a)) and section 107 of S. 1388 as ordered reported are premised on the committee's policy that, in fiscal year 1985 and subsequent years, compensation/DIC COLA's should be provided on the same date as social security/VA-pension COLA's.

The 2-month delay—from October 1 to December 1—in the fiscal year 1985 and 1986 COLA's would, according to CBO, achieve savings of $78 million in budget authority and $77 million in outlays in fiscal year 1985 and $78 million in both budget authority and outlays in fiscal year 1986. When added to the projected savings that the enactment of a 3.5-percent COLA in fiscal year 1984 would achieve, as discussed above, the total savings equal the savings required by the reconciliation instructions for fiscal years 1985 and

1986—$139 million in budget authority and $138 million in outlays in fiscal year 1985 and $141 million in budget authority and $140 million in outlays in fiscal year 1986.

CONGRESSIONAL BUDGET OFFICE

COST ESTIMATE

August 1, 1983

1. BILL TITLE:

Provisions reducing spending in programs within the jurisdiction of the Senate Committee on Veterans' Affairs.

2. BILL STATUS:

As ordered transmitted to the Senate Committee on the Budget by the Senate Committee on Veterans' Affairs, July 21, 1983.

3. BILL PURPOSE:

To reduce expenditures authorized by the Senate Committee on Veterans' Affairs in response to budgetary requirements established for that Committee by the First Concurrent Resolution on the Budget for Fiscal Year 1984.

4. ESTIMATED COST TO THE FEDERAL GOVERNMENT:

(by fiscal year, in millions of dollars)

	1984	1985	1986	1987	1988
Change from baseline:					
Required Budget Authority	-228.0	-139.0	-141.0	-64.0	-66.0
Estimated Outlays	-226.0	-138.0	-140.0	-64.0	-65.0
Change from current law:					
Required Budget Authority	0.0	0.0	0.0	0.0	0.0
Estimated Outlays	0.0	0.0	0.0	0.0	0.0

The effect of this bill would fall in budget function 700.

Basis for estimate:

Section 401 (a) would provide that any legislation enacted to increase the rates of disability compensation or dependency and indemnity compensation (DIC) during fiscal year 1984 would not increase such rates to the extent that the cost of such legislation in fiscal year 1984 would exceed $175.5 million in budget authority or $145.3 million in outlays.

Section 402 (b) would provide further that any legislation to increase the rates of disability compensation or DIC that is enacted to take effect in fiscal year 1985 or 1986 would not take effect before December 1 of each such fiscal year.

The baseline projection of the compensation programs assumes that cost-of-living increases in the monthly benefit rates of these programs will be enacted each year to take effect on October 1, as has been Congressional practice in recent years. Furthermore, this projection was based on CBO economic assumptions of January, 1983 and, thus, reflected an anticipated fiscal year 1984 compensation COLA of 4.1

BEST COPY AVAILABLE

percent. This estimate assumes that the ceiling on the cost of the fiscal year 1984 COLA mandated by section 401 would be achieved by delaying the effective date of the COLA to April 1, 1984 and by reducing the percentage increase to 3.5 percent. If taken, these actions would result in a 1984 cost to current law for the COLA estimated at $175.5 million in budget authority and $145.3 million in outlays. Since the COLA is not actually authorized by this provision, however, no cost to current law would result from its enactment. The provision would, nevertheless, effect savings from the baseline projection. These are estimated at $228 million and $226 million, respectively, in 1984 budget authority and outlays.

If the fiscal year 1985 and 1986 compensation COLAs should be enacted to take effect on December 1 of each year, the outlay savings from the baseline projection for 1985 and 1986 is estimated at $77 million and $78 million, respectively. In addition, there would be an outlay savings in these years also from the reduction of the 1984 COLA from 4.1 to 3.5 percent. These savings are estimated at $61 million in 1985 outlays and $62 million in 1986.

The savings shown for fiscal years 1987 and 1988 represent the outyear effects of the assumed reduction in the 1984 COLA from 4.1 to 3.5 percent. If the ceiling on the cost of the 1984 COLA should be achieved in a manner different from that assumed for this estimate, the savings in 1985-1988 could be significantly different from those shown above.

The costs of compensation COLAs are estimated by multiplying the projected average cost in each year for all disability compensation cases and for all DIC cases by the percentage increase in benefit rates. The resulting average increases in costs per year are then multiplied by the estimated number of cases in each program each year to determine the annual cost. It was estimated that approximately 49.9 percent of fiscal year 1984 current law cost would occur between April 1 and September 30, 1984. This percentage was then applied to the total 1984 cost for the rate increase to reflect the April 1 effective date. Similar percentages of full year costs were calculated for the December 1 through September 30 periods in 1985 and 1986 and then applied to the full year COLA costs to reflect the effective dates in those years.

5. ESTIMATED COST TO STATE AND LOCAL GOVERNMENTS:

The Congressional Budget Office has determined that the budgets of state and local governments would not be directly affected by the enactment of this bill.

6. ESTIMATED COMPARISON: None.

7. PREVIOUS CBO ESTIMATE: None.

8. ESTIMATE PREPARED BY: K.W. Shepherd (226-2820)

9. ESTIMATE APPROVED BY:

James Blum

James L. Blum
Assistant Director
for Budget Analysis

25-561 O—83——15

BEST COPY AVAILABLE

SECTION-BY-SECTION ANALYSIS OF TITLE IV

VETERANS' BENEFITS AND SERVICES

Section 401

Subsection (a) of section 401 would place a cap of $175.5 million in budget authority and $145.3 million in outlays on the fiscal year 1984 costs of legislation that would increase, effective in fiscal year 1984, rates of service-connected disability compensation payable to veterans and of disability and indemnity compensation (DIC) payable to the survivors of those who die from service-connected disabilities (under chapters 11 and 13, respectively, of title 38, United States Code).

Compared to the Congressional Budget Office baseline estimate for the compensation and DIC programs, which assumes the enactment of a 4.1-percent COLA for these programs effective October 1, 1983, costing an estimated $403.5 million in budget authority and $371.3 million in outlays, the enactment of section 401(a) would, according to CBO, result in savings of $228 million in budget authority and $226 million in outlays in fiscal year 1984, $61 million in both budget authority and outlays in fiscal year 1985, and $63 million in budget authority and $62 million in outlays in fiscal year 1986.

Subsection (b) of section 401 would prohibit legislation providing a compensation or DIC COLA in fiscal year 1985 from taking effect before December 1, 1984, and legislation providing a compensation or DIC COLA in fiscal year 1986 from taking effect before December 1, 1985.

Compared to the CBO baseline estimates for the fiscal years 1985 and 1986 compensation/DIC COLA's, which assume that these COLA's would take effect on October 1, 1984, and October 1, 1985, respectively, the enactment of section 401(b) would, according to CBO, result in savings of $78 million in budget authority and $77 million in outlays in fiscal year 1985 and $78 million in both budget authority and outlays in fiscal year 1986.

Total savings: CBO estimates that the total savings resulting from the enactment of section 401 would be as follows: $228 million in budget authority and $226 million in outlays in fiscal year 1984, $139 million in budget authority and $138 million in outlays in fiscal year 1985, and $141 million in budget authority and $140 million in outlays in fiscal year 1986.

VIEWS OF BUDGET COMMITTEE MEMBERS

ADDITIONAL VIEWS OF SENATOR ERNEST F. HOLLINGS

There is an old saying that states a "trip of 1,000 miles begins with one step." Unfortunately, it does not cover a step backwards, which is what we have with this reconciliation bill. Not only is this so-called budget reduction measure inadequate, but it is unfair and it may well be the low-water mark of the 7-year history of the budget process.

With deficits projected in the $200 billion plus range for the next 5 years, a $28 billion package is simply not enough. In this environment, how can this be called a significant achievement when all we are really talking about is reducing the deficit by $9 billion a year. The real impact is only to lower $200 billion in annual red ink to $191 billion. I have long believed in the power of positive thinking, but something more in the nature of the "fishes and loaves" would have to occur for this bill to have any impact on our economy or government.

I agree with the chairman and the ranking member that this has been an extraordinarily difficult year. But describing the situation is no substitute for analyzing and controlling it. This year's budget was stillborn in May. Even if the entire reconciliation instruction had been achieved—$85 billion in taxes and spending cuts—the deficits would have been in excess of $130 billion in 1988. Politically, the Senate was told 6 months ago that the Finance Committee could not meet its instructions. And, of course, we have known for the last 3 years where the President stands.

Yet against these formidable odds the Budget Committee chose a course of half-way measures and least resistance. It was a difficult choice, and as former chairman I understand the problems of developing a consensus. But I also know that it is nearly impossible to recruit and hold supporters when the costs so obviously exceed the benefits. It is one thing to join a suicide mission that will balance the budget. It is quite another thing to expect people to join when the mission leaves the deficits at staggering levels.

This reconciliation bill is also unfair. On the revenue side, it refuses to recognize that the Kemp-Roth tax bill is the source of our problems. It was not sport fishing, excise taxes, income averaging, or collapsible corporation taxes that started the $750 billion reve-

nue hemorrhage in 1981. It was not minimum income taxes, corporate graduated rates, or public property leasing that resulted in the great tax giveaway to the rich 3 years ago. It was not any of the dozen new taxes in this bill that started our problems. It was the ill-conceived and ill-founded supply side nonsense called Kemp-Roth. That frenzy of tax cutting simply went too far and should be reigned in. This is the third straight year that we are incrementally taxing our citizens into poverty—all in order to preserve a tax cut that originated in the doodlings of some economist on a restaurant napkin. Well enough is enough. It is time to finally own up to the mistake and start to correct it

On the spending side, this bill is equally unfair. How many more times can we single out the elderly dependent on medicare, the poor receiving SSI, medicaid, and medicare, the retirees in need of cost-of-living adjustments, and the civil servants who deserve a pay raise to take cutbacks in order to balance the budget? How many more times can we allow the defense budget to escape real scrutiny?

The answer is that we can't anymore. Anyone who has looked at the numbers realizes that continuing the assault on the social safety net is not only unfair but also ineffective—it simply will not balance the budget. And, anyone who has looked at the numbers knows that the defense budget must be controlled. It is a major source of the deficit and it should not continue to escape review.

What is needed is a shared sacrifice that freezes the budget across-the-board. The deficit problem is rooted in the entire budget—taxes and spending—and the entire budget must therefore be our focus. A budget freeze will halt the cutbacks in social programs. A budget freeze will provide an excellent defense and meet our NATO commitment. And, a budget freeze will go to the source of our revenue problems and instead of adding hundreds of new pages to the IRS code, it will just rip out a few useless ones.

I know the feelings of the Senate about this proposal. I only wish that my colleagues could find out how the rest of the country responds to it. They could find that business, which only needs a sign that we are serious about these deficits, is almost unanimous in its endorsement of this approach. They would find that retirees, civil servants, and others are willing to join in a program that will reduce the deficit if it is fair and across-the-board. They would find that the Defense Department is incapable of productively spending all of the money it is receiving. In short, they would learn that there is support for this proposal because businesses, unions, state houses, and city halls have all had to freeze their budgets to survive. The only question is why we here in Washington can not do the same?

The only excuse that I can think of is that Washington believes President Reagan and Secretary Regan. They have bought the line that all is well and that deficits don't matter. However, all is not well and these deficits do matter because they will destroy this recovery. Keep in mind that real interest rates have not declined in the last 3 years, that real capital investment has declined for 2

straight years, that 500 businesses a week are still going bankrupt, and that the savings rate is at a 30-year low. Keep in mind that we are facing a credit crunch that will stop this recovery in its tracks—already, the Government is borrowing 98 percent of net private savings. And keep in mind that the crowd with the rosey projections is the same crowd that started the worst recession since World War II.

There are no easy answers to our problems. But my feeling is that we are digging ourselves deeper into the hole with this reconciliation bill. We need stronger medicine and we need it now. And win, lose, or draw, I think it is better to attempt to do what is right rather than attempt another anemic solution. We know what the problems are and we know what the answers are. The only question is, why are we waiting.

ERNEST F. HOLLINGS.

ADDITIONAL VIEWS OF SENATOR JIM SASSER

During consideration of the First Concurrent Budget Resolution for the current fiscal year, the administration lobbied hard to obstruct the budget process, the same process which has served them so well during the past 2 years.

It now appears as though after 9 months they very well may have succeeded in doing just that. The budget reconciliation package adopted by this committee is fundamentally deficient in two respects: one, it does not sufficiently address the deficit problem confronting the country, either in the current fiscal year or beyond; and two, it represents a significant deviation from the hard-won bipartisan compromise budget adopted by Congress earlier this year.

On the first point, as we wade into the current fiscal year, the same one which was to have given us a balanced budget under the original Reagan economic program, we find ourselves staring directly down the barrel of a cannon loaded with $200 billion plus deficits for now and the foreseeable future. Despite the contention of certain administration officials that deficits do not matter, economic rationale and common sense dictate otherwise. The impact of these levels of budget deficits on interest rates is, in the words of the President's Chief Economic Advisor, Dr. Martin Feldstein "unambiguous".

Deficit spending can serve a stabilizing economic function. However, deficits which comprise 4, 5, or 6 percent of the Nation's gross national product, as anticipated under current Congressional Budget Office projections, can only serve to exacerbate the continuing interest rate calamity.

Before this administration took office, real interest rates, that is interest rates adjusted for inflation, were in the range of 1.6 percent. Today, they are 6 percent. With $200 billion deficits "as far as the eye can see", there is little hope that the historically high real interest rates which are killing small businesses and farmers will improve.

Further, these deficit levels place tremendous pressures on an already fragile recovery. If we fail to address the deficit problem in an effective way, we risk short-circuiting the current recovery and falling into a recession even deeper than the one precipitated by the Reagan economic program.

On the second point, the reconciliation package adopted by this committee yesterday significantly veers off of the path outlined by this committee, and by the Congress as a whole, just a few short months ago. The tough, responsible actions taken during the

summer have fallen like the leaves from the trees this time of year in Washington. The First Budget Resolution called for a mixture of $73 billion in revenue increases, largely acknowledged to be obtained from tightening tax loopholes, and $12 billion in spending reductions. These cumulative savings were to be accomplished over the next 3 years. The package presented to this committee is substantially short on the revenue side. The package contains only $13.4 billion in revenue increases over the next 3 years.

The package is laudable with respect to the tax revisions it contains. It is a good starting point. However, it stops far short of critically needed action.

I supported adoption of this package only reluctantly, and for strategic reasons which, in my estimation, superceded its substantive deficiencies. Because of rules peculiar to the reconciliation process, we were unable to amend this package in committee. Thus, I believe it is important that we have an opportunity to put reconciliation back on the right course by allowing for debate and amendment on the Senate floor.

The budget reconciliation has been reported out of committee without recommendation. This should signal a strong statement to our colleagues of the need for further improvement of the measure. It is my sincere hope that fiscally responsible improvements be made on the Senate floor. It is for this reason, and this reason alone, that I supported passage of this measure.

JIM SASSER.

ADDITIONAL VIEWS OF SENATOR DONALD W. RIEGLE, JR.

Contrary to the economic theory emerging from some corners that deficits don't matter, most responsible policymakers realize that we must substantially reduce the $200 billion deficits that plague us for as far into the future as the eye can see. If we do not move quickly to address these massive deficits we run the risk of choking off the current recovery before it hs fully taken hold.

The recently announced deficit for fiscal year 1983 of over $195 billion is over $15 billion more than the much criticized Carter cumulative 4-year deficit of $180 billion. In fact, if we include the projected deficit for the 3 years covered in this bill together with the deficit we have accumulated over the last 3 years, we will discover that the national debt will just about double in 6 short years.

How did we arrive at this dangerous deficit situation; a course clearly headed for disaster? What has happened over the past few years under the Reagan administration to bring us to the point where we are not only mortgaging the future for our children, but perhaps precipitating an economic disaster with the result of putting into question the fundamental ability of our democratic institutions to respond to our strategic responsibilities at home and abroad.

To answer these questions we must look at the economic policy actions taken by the Reagan administration. The table below prepared by CBO tells the whole story.

Differences Between July 1981 and February 1983 Baseline Deficit Projections Attributable to Legislative Action

[By fiscal year, in billions of dollars]

	1982	1983	1934	1985	1986
Tax reductions	38	68	93	121	154
Defense spending increases	1	15	27	47	65
Nondefense spending cuts	−42	−47	−56	−59	−61
Effect of legislative actions on interest costs	1	2	7	15	25
Total legislative actions.	−1	37	71	124	183

Contrary to what the Reagan administration and their followers would like the American people to believe, the massive deficits we are now experiencing are not a result of an unrestrained Congress spending the country into bankruptcy. In actuality, the legislative actions we have taken have reduced non-defense spending over a 5-year period by $265 billion. Unfortunately, more than half of that reduction was wiped out by a 5-year increase in defense spending totalling $155 billion. Nevertheless, even with this massive and unprecedented peacetime military build-up, the Federal Government still netted a savings of $110 billion. The problem becomes clear when we look at tax reductions. For even when we include the recent social security tax and other tax increases, the net revenue reductions over this same period total $469 billion. The result of all of these legislative actions is a cumulative 5-year deficit of $414 billion and a structural deficit in fiscal year 1986 approaching the $150 billion mark.

As I have mentioned, we are facing these deficits due to the economic policies that have called for significant reductions in the revenue base of the Federal Government while simultaneously recommending excessive and wasteful increases in military spending far beyond what is needed and what can be responsibly spent. In an attempt to make up part of this redirecting of resources, we have witnessed a significant retreat from vital domestic programs which have provided basic sustenance for millions of Americans. And now we are being asked to cut doimestic spending even more to help reduce the Reagan deficits. The congressional budget resolution, which passed both Houses of Congress after much controversy and debate, calls for over $59 billion in new revenues beyond what is contained in the reconciliation bill in an effort to help deal with the structural deficit.

When we talk aboiut balancing tax increases with spending cuts, we must take into consideration the actions we have taken over the past 3 years. When the President talks about how Congress has acted irresponsibly and has failed to get spending under control, he is either ignoring or distorting recent history. In fact, the Congress has approved less spending than President Reagan has asked for.

The high deficits are not due to congressionally mandated runaway spending, but rather because of the recent poor performance of the economy coupled with the significant erosion of the Federal Government's revenue base and too much spending on defense. Even if the current recovery were to bring us to so-called "full employment", we would still have permanent $100 billion plus deficits. Over the past 3 years we have cut domestic spending by over one-fourth of a trillion dollars and I believe additional massive savings in the area are unachievable.

What is needed are new revenue measures that close existing loopholes that do not strengthen the productivity of the American economy. While major reform of the tax code is clearly something we need to consider, we also need to return to the Federal Treasury the billions of dollars that escape collection under current law. In developing new tax policy, we must be careful to preserve incentives for small business to invest and prosper.

In addition to developing new tax policies, we need to develop a coherent national trade policy that is conducive to the sale of American products abroad, while providing adequate safeguareds to make sure free trade is practiced by all countries not just the United States. We desperately need a coordinated mix of fiscal and monetary policies designed to move us into a high growth, full employment path. For unless we see a sharp decline in interest rates, we are going to have an uneven recovery lasting only months rather than years.

DONALD W. RIEGLE, Jr.

ADDITIONAL VIEWS OF SENATOR J. JAMES EXON

I have voted to send this package to the floor of the Senate because Congress cannot afford to further delay seriously addressing the huge budget deficits rolled up over the last 3 years.

There are some good things to be said about this package. It is at least a place to start. Three of the four committees have met their reconciliation instructions. I am especially pleased to see the Finance Committee address the prospective payment wage index. The current regulations issued by the Department of Health and Human Services fail to consider the use of part-time employees when computing the wage index. If left unchanged, many rural hospitals would be unfairly treated under the prospective payment system.

Unfortunately, in total, this package falls far short of what should be done. During ordinary times, $28 billion in deficit reductions would be something to cheer about. However, these are not ordinary times. The deficits have grown to such a huge level as to create a real crisis. Our high real interest rates, over-valued dollar, and current economic uncertainty can be traced back to the rapid growth in the Federal deficit.

During the consideration of the first budget resolution, Senators Johnston, Nunn, Boren, and I presented a budget plan that could have balanced the Federal budget as early as 1988. I hope that in addressing the deficit crisis my colleagues would again consider our proposal.

We cannot continue with business as usual. Our failure to act would burden further future generations with our debt. Interest expenses on the national debt have become a larger and larger part of our Federal budget. As a percentage of Gross National Product, it is expected to grow from 2.3 percent in fiscal year 1983 to 3.2 percent in fiscal year 1989. This trend must be stopped. Each dollar spent on interest represents a foregone opportunity.

Now is the time to put politics aside. We must work together and make the difficult choices and make the necessary compromises. The cost of delay is simply too great.

J. JAMES EXON.